

# Select Committee on Pension Policy

P.O. Box 40914  
Olympia, WA 98504-0914  
actuary\_st@leg.wa.gov

**October 18, 2005**

10:00 am - 1:30 pm  
House Hearing Room A  
Olympia

## AGENDA

- 10:00 AM (1) **Approval of Minutes**
- 10:05 AM (2) **Introduction of New Staff** - Matt Smith, State Actuary
- 10:10 AM (3) **Revised SCPP Goals** - Matt Smith
- 10:30 AM (4) **Plan 1 Unfunded Liability Subgroup Report** - Victor Moore - Director, Office of Financial Management
- 11:00 AM (5) **Disability Retirement** - Bob Baker, Senior Research Analyst
- 11:30 AM (6) **Accounting for Post-Retirement Medical Benefits** - Philip Martin McCaulay - Senior Pension Actuary
- NOON (7) **Medicare Part D Briefing** - Bob Baker
- 12:30 PM (8) **Public Testimony**

### POSSIBLE EXECUTIVE SESSION

- 1:00 PM (9) **TRS Out-of-State Service Credit**
- 1:15 PM (10) **Plan 3 Vesting**
- 1:30 PM (11) **Adjourn**

**\*Elaine M. Banks**  
*TRS Retirees*

**Representative Barbara Bailey**

**Lois Clement**  
*PERS Retirees*

**Representative Steve Conway**

**Representative Larry Crouse**

**\*Senator Karen Fraser,**  
*Vice Chair*

**\*Representative Bill Fromhold,**  
*Chair*

**\*Leland A. Goeke**  
*TRS and SERS Employers*

**\*Robert Keller**  
*PERS Actives*

**\*Sandra J. Matheson,** Director  
*Department of Retirement Systems*

**Corky Mattingly**  
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**Doug Miller**  
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**Diane Rae**  
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**J. Pat Thompson**  
*PERS Actives*

**David Westberg**  
*SERS Actives*

**\* Executive Committee**

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# Select Committee on Pension Policy

## 2005 Meeting Schedule

(August 24, 2005)

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### **June 20, 2005**

10:00 AM - 6:30 PM

Senate Hearing Room 1  
Orientation

### **September 27, 2005**

10:00 AM - 1:30 PM

House Hearing Room A

### **June 21, 2005**

9:30 AM - 12:30 PM

Senate Hearing Room 4

### **October 18, 2005**

10:00 AM - 1:30 PM

House Hearing Room A

### **July 19, 2005**

10:00 AM - 1:30 PM

House Hearing Room A

### **November 15, 2005**

House Hearing Room A

### **August 23, 2005**

10:00 AM - 1:30 PM

House Hearing Room A

### **December 13, 2005**

House Hearing Room A

# Select Committee on Pension Policy

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## FULL COMMITTEE DRAFT MINUTES

September 27, 2005

The Select Committee on Pension Policy met in House Hearing Room A, Olympia, Washington on September 27, 2005.

Committee members attending:

Senator Fraser, Vice Chair  
Elaine Banks  
Representative Bailey  
Representative Crouse  
Leland Goeke  
Robert Keller  
Sandra J. Matheson  
Corky Mattingly

Doug Miller  
Victor Moore  
Senator Mulliken  
Glenn Olson  
Senator Pridemore  
Diane Rae  
J. Pat Thompson  
David Westberg

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**\* Executive Committee**

Senator Fraser, Vice Chair, called the meeting to order at 10:05 AM.

### (1) Approval of Minutes

*It was moved to approve the August 23, 2005 Draft Minutes.*  
Seconded.

### MOTION CARRIED

Sandra Matheson, Director, Department of Retirement Systems, informed the members that the IRS has qualified PERS and SERS Plan 3 with one exception and that the qualification is in hand. The qualification excludes the annual window for PERS 3 and SERS 3 members to change salary deferral percentages.

### (2) USERRA Compliance Update

Jilene Siegal, Department of Retirement Systems, presented a report on "USERRA Compliance Update."

The following people testified:

*Mike Ryherd, Teamsters*

*Jim Densley, Washington Committee for Employer Support of the Guard and Reserve*

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**(3) Judges Benefit Multiplier**

Bob Baker, Senior Research Analyst, presented a report on "Judges Benefit Multiplier."

The following person testified:

*Judge Leonard Costello*, Superior Court Judges' Association

**(4) Service Credit Purchases**

Laura Harper, Senior Research Analyst - Legal, presented a report on "Service Credit Purchases."

The following people testified:

*Mike Ryherd*, Teamsters

*Tom Parker*, testified on behalf of the Former Port Commissioners

**(5) PSERS Eligibility**

Bob Baker, Senior Research Analyst, presented a report on "PSERS Membership Policy."

Dave Nelsen, Assistant Director of Administrative Services, Department of Retirement Systems, presented a report on "Public Safety Employees Retirement System."

The following people testified:

*Dennis Orthmann*, IBEW #77

*Craig Lian*, IBEW #77

*Steve Davis*, IBEW #77

*T. Paul Schell*, IBEW #77

*Don Guillot*, IBEW #77

*Beverly Hermanson*, Washington Federation of State Employees

*Lynn Maier*, Washington Public Employees Association

*Mike Ryherd*, Teamsters

**(6) LEOFF 1 Benefit Cap**

Bob Baker, Senior Research Analyst, presented a report on "LEOFF 1 Benefit Cap."

The following people testified:

*Dick Warbrouck*, Retired Firefighters of Washington

*Kelly Fox*, Washington State Council of Fire Fighters

*Jim Justin*, Association of Washington Cities

**(7) Public Testimony**

The following person testified:

*Ken Kanikeberg*, Public School Employees

The meeting adjourned at 1:05 PM.

# Select Committee on Pension Policy

## Goals for Washington State Public Pensions

*Adopted August 23, 2005  
Revised September 29, 2005*

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1. Contribution Rate Setting: To establish and maintain adequate, predictable and stable contribution rates, with equal cost-sharing by employers and employees in the Plans 2, so as to assure the long-term financial soundness of the retirement systems.
2. Balanced Long-Term Management: To manage the state retirement systems in such a way as to create stability, competitiveness, and adaptability in Washington's public pension plans, with responsiveness to human resource policies for recruiting and retaining a quality public workforce.
3. Retirement Eligibility: To establish a normal retirement age for members currently in the Plans 2/3 of PERS, SERS, and TRS that balances employer and employee needs, affordability, flexibility, and the value of the retirement benefit over time.
4. Purchasing Power: To restore lost purchasing power and, to the extent feasible, to increase future purchasing power of retiree benefits in the Plans 1 of PERS and TRS while providing long-term benefit security to retirees.
5. Consistency with the Statutory Goals within the Actuarial Funding Chapter: To be consistent with the goals outlined in the RCW 41.45.010:
  - a. to provide a dependable and systematic process for funding the benefits to members and retirees of the Washington State Retirement Systems;
  - b. to continue to fully fund the retirement system plans 2 and 3, and the Washington State Patrol Retirement System, as provided by law;
  - c. to fully amortize the total costs of PERS 1, TRS 1 and LEOFF 1, not later than June 30, 2024;
  - d. to establish predictable long-term employer contribution rates which will remain a relatively predictable portion of future state budgets; and
  - e. to fund, to the extent feasible, benefit increases over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service.

# Select Committee on Pension Policy

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## PLAN 1 UNFUNDED LIABILITY SUBGROUP DRAFT MINUTES

October 3, 2005

The Plan 1 Unfunded Liability Subgroup met in House Briefing Room, Olympia, Washington on October 3, 2005.

### SCPP and Voting Members:

Victor Moore, Chair  
Senator Craig Pridemore  
Representative Bailey by phone  
Glenn Olson

Victor Moore, Chair, called the meeting to order at 2:14 PM.  
Chair Moore discussed the duties of the subgroup.  
Chair Moore handed out and reviewed the "Six Year Outlook" table.

#### (1) Review of Options

- Option 2 - Resume Plan 1 UAAL payments
- Option 4 - Phase-in a step up of UAAL rates
- Option 5 - Establish rate floor with target funding ratio

Matt Smith, State Actuary, presented the report entitled "Review of Options." Discussion followed.

#### (2) Role of SCPP - Discussion

The subgroup decided to pursue specific recommendations and requested that staff prepare several phase-in options to be presented at next subgroup meeting.

#### (3) Next Steps

Staff was asked to poll the members for their availability for a meeting prior to the November 15, 2005 SCPP Full Committee meeting.

The meeting adjourned at 4:00 PM.

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**\*Elaine M. Banks**  
*TRS Retirees*

**Representative Barbara Bailey**

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*PERS Retirees*

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# Select Committee on Pension Policy

P.O. Box 40914  
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**October 25, 2005**

1:00 pm - 3:00 pm  
House Hearing Room C

## Plan 1 Unfunded Liability Subgroup

### AGENDA

- (1) Approval of Minutes**
- (2) Reports on Revenue Forecasts/Impacts**
  - Local Sources - Glenn Olson
  - State Non-GFS - Victor Moore
- (3) Phase-In Proposals - Marty McCaulay**
- (4) Rate Floor with Target Funding Ratio - Matt Smith**
- (5) Next Steps**

*SCPP and voting members: Victor Moore (chair); Senator Craig Pridemore;  
Representative Barbara Bailey; Glenn Olson.*

Persons with disabilities needing auxiliary aids or services for purposes of attending or participating in Select Committee on Pension Policy meetings should call (360) 753-9144. TDD 1-800-635-9993:

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**\*Elaine M. Banks**  
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## Disability Retirement

Select Committee on Pension Policy  
October 18, 2005



Robert Wm. Baker  
Senior Research Analyst

### Current Disability Policy (non public safety)

- Retirement plans do not provide for unreduced disability benefits.
- Financial protection provided through:
  - Workers' Comp.;
  - Social Security; and,
  - Long Term Disability insurance.

## Plan 2/3 Disability Retirement Benefit

- Members who are disabled, i.e. totally incapacitated for continued employment, are eligible for a retirement allowance based upon service credit and actuarially reduced from age 65.

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## PERS 2/3 Disability Retirements\*

|                              | PERS 2  | PERS 3  |
|------------------------------|---------|---------|
| <b>Count</b>                 | 1,285   | 18      |
| <b>Avg. Retirement Age</b>   | 57.0    | 56.2    |
| <b>Avg. Member Service</b>   | 12.4    | 15.7    |
| <b>AFC (monthly)</b>         | \$2,542 | \$4,222 |
| <b>Avg. Base benefit</b>     | \$632   | \$661   |
| <b>Avg. benefit Received</b> | \$332   | \$267   |

\* Elected a life annuity in lieu of a return of accumulated member contributions.

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## Plan 2/3 Benefit Reduction for Disability

|                             |         |
|-----------------------------|---------|
| Age                         | 55      |
| Average Final Compensation  | \$4,000 |
| Years of Service            | 20      |
| Base Percent                | 40%     |
| Base Benefit (monthly)      | \$1,600 |
| Actuarial Adjustment Factor | .37     |
| Adjusted Benefit (monthly)  | \$592   |

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## Legislative History

- ❖ LEOFF 2 Board.
- ❖ Chapter 451, Laws of 2005.
  - Removed the actuarial reduction for duty-disability retirements.

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## Comparative Systems Disability Provisions

- ❖ No actuarial reductions.
- ❖ Benefits based on:
  - Fixed percent of salary.
  - Assumed benefit at normal retirement age.
- ❖ Off-sets against workers' comp.
- ❖ Immediate eligibility for duty disability.
- ❖ Length-of-service standards for regular, non-duty disability.

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## Comparative Systems Disability Standards

- ❖ Unable to perform job:
  - Unable to perform any other job.
- ❖ Loss of earnings
  - 20 percent loss in Missouri.
  - 25 percent loss in Colorado.
  - 40 percent loss in Wisconsin.

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## CalPERS Disability Standard

- ❖ Illness or injury that:
  - Prevents the member from performing their job duties;
    - ▢ With current employer.
    - ▢ Any other CalPERS employer.
  - No other positions reasonably comparable in pay, benefits, and promotional opportunities the member can perform.

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## Colorado PERA Disability Standard

- ❖ Totally and permanently disabled from:
  - Engaging in any regular and substantial gainful employment.
    - ▢ 75 percent of pre-disability earnings.

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## Florida FRS Disability Standard

- ❖ Totally and permanently disabled:
  - Unable to work.

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## Idaho PERSI Disability Standard

- ❖ Physical or mental impairment:
  - Considered total and permanent.
  - Prevents member from earning a livelihood.

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## Iowa IPERS Disability Standard

- ❖ Member is receiving Social Security disability or Railroad Retirement disability benefits.

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## Minnesota MSRS Disability Standard

- ❖ Member has three or more years of service.
- ❖ Unable to engage in any substantial gainful activity:
  - Any medically determinable physical or mental impairment that:
    - ⇒ Existed for, or is expected to continue for, a period of at least one year.

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## Missouri MOSERS Disability Standard

- ❖ Unable to perform with reasonable continuity the material duties of **own** occupation and loss of at least 20 percent of pre-disability earnings.
- ❖ Unable to perform the material duties of **any** occupation – one in which the member could earn at least 60 percent of their pre-disability earnings.

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## Wisconsin WRS Disability Standard

- ❖ A total and permanent disability:
  - Confirmed by two physicians.
  - Prevents member from any further gainful employment.
    - 60 percent of final average earnings.
- ❖ Assumes member would also qualify for Social Security disability benefit.

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## Disability Percent of Total Retirees

|                    |                     |
|--------------------|---------------------|
| California CalPERS | Reg. 7.7% Ind. 6.3% |
| Colorado PERA      | 11.0%               |
| Florida FRS        | 5.8%                |
| Idaho PERSI        | 3.8%                |
| Iowa IPERS         | 3.5%                |
| Minnesota MSRS     | 6.2%                |
| Missouri MOSERS    | 0.1%                |
| Ohio OPERS         | 13.6%               |
| Oregon PERS        | Duty 0.6% ND 3.5%   |
| Seattle SCERS      | 1.8%                |
| Wisconsin WRS      | 5.0%                |
| Washington Plans   | 3.9%                |

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## Other Disability Benefits

- Workers' Compensation.
- Long-Term Disability Insurance.
- Social Security.

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## Workers' Compensation

- ❖ Time-loss benefits:
  - Partial permanent disabilities.
  - Total permanent disabilities.
- ❖ Pension survivor options.
- ❖ 60-75 percent of gross income:
  - \$46,553 maximum.
  - Tax free.

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## Long-term Disability (LTD) Insurance

- ❖ Offered through PEBB.
- ❖ Protection outside the workplace.
- ❖ Basic Coverage: \$240 / month.
- ❖ Optional Coverage: 60 percent of the first \$10,000 per month salary.
  - 120 day wait – 0.37 percent of pay.

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## Social Security Disability

- ❖ Available to those completely unable to work.
- ❖ No partial or short-term disability.
- ❖ Disability to last at least one year or result in death.

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## Plan 2/3 Disability Policy (non public safety)

- ❖ Disability retirement benefit treated like early retirement not disability insurance.
- ❖ Financial protection through Workers' Comp. and Social Security
- ❖ Members responsible for additional LTD insurance coverage.

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## Disability Policy Questions

- ❖ Should worker disability issues be addressed outside or within the retirement plans?
- ❖ Should the retirement plans provide disability insurance kinds of benefits?
- ❖ Should the retirement plans make distinctions between duty and non-duty disabilities?

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## Disability Policy Questions

- ❖ Should payment of Long-Term Disability insurance premiums be a member responsibility, an employer responsibility, or a shared responsibility?
- ❖ Should any disability benefit improvement be retroactive (benefit issues are invariably considered after the fact)?

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## Next Steps

### ■ Executive Committee direction to staff:

- Further 2005 study.
- Defer until the 2006 interim.

# Select Committee on Pension Policy

## Disability Retirement

(October 7, 2005)

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### Issue

The current structure of the Plan 2/3 retirement systems does not provide for unreduced disability benefits. Financial protection from disability is, instead, provided through Workers' Compensation, Social Security, and supplemental Long Term Disability insurance.

Plan 2/3 members of PERS, SERS, and TRS who are disabled, i.e. totally incapacitated for continued employment, are eligible for a retirement allowance that is based upon service credit and actuarially reduced from age 65.

### Staff

Robert Wm. Baker, Senior Research Analyst  
(360) 786-6144

### Members Impacted

This issue would impact all Plan 2/3 members of PERS, SERS, and TRS who become injured to the extent that it prohibits them from continuing employment in their existing job.

### Current Situation

A member who is incapacitated and retires as a result of disability may receive a retirement benefit that is actuarially reduced from age 65. This is a common provision within Plan 2/3 design. As a result, a disability retirement is treated like an early retirement and there is no distinction between a duty-related disability and a non-duty-related disability.

An actuarial reduction for early retirement can average more than 8 percent per year compounded (see Figure 1).

| <b>Figure 1</b>                              |               |
|--|---------------|
| <b>Plan 2/3 Actuarial Adjustment Factors</b> |               |
| <b>Years Early</b>                           | <b>Factor</b> |
| 1  | .91           |
| 2  | .82           |
| 3  | .73           |
| 4  | .67           |
| 5  | .61           |
| 6  | .55           |
| 7  | .49           |
| 8  | .43           |
| 9  | .40           |
| 10   | .37           |

**Example**

A member who became disabled and had to retire at age 55, and was not eligible for an alternate early retirement, would have the base benefit multiplied by a factor of 0.37 and would see the benefit reduced to 37 percent of its base amount (see Figure 2).

| <b>Figure 2</b>                                   |         |
|---|---------|
| <b>Plan 2/3/ Benefit Reduction for Disability</b> |         |
| Age   | 55      |
| Average Final Compensation                        | \$4,000 |
| Years of Service                                  | 20      |
| Base Percent                                      | 40%     |
| Base Benefit (monthly)                            | \$1,600 |
| Actuarial Adjustment Factor                       | 0.37    |
| Adjusted Benefit (monthly)                        | \$592   |

In this example, the benefit for a disability retirement would be identical to the benefit for a member who opted for an early retirement. The

principal difference between early retirement and disability retirement is that to qualify for an early retirement a member needs to meet age and service requirements – age 55 with 20 years of service for an actuarially reduced pension, age 55 with 30 years of service for an alternate early retirement (reduced 3 percent per year) – members have no age and service requirements to qualify for a disability pension.

There are currently a total of 1,522 disability retirees from the PERS, SERS, and TRS Plans 2/3 (see Figure 3). This figure may understate the incidence of disability in these plans because of the options to receive the benefit in the form of a lump-sum or a refund of the member's contributions and interest.

**Figure 3**  
**Plan 2/3 Disability Retirements**

|                              | PERS 2  | PERS 3  | TRS 2   | TRS 3   | SERS 2  | SERS 3  |
|------------------------------|---------|---------|---------|---------|---------|---------|
| <b>Count</b>                 | 1,285   | 18      | 71      | 30      | 95      | 23      |
| <b>Avg. Ret Age</b>          | 57.0    | 56.2    | 55.8    | 53.3    | 57.9    | 57.8    |
| <b>Avg. Member Service</b>   | 12.4    | 15.7    | 11.7    | 13.7    | 14.0    | 17.0    |
| <b>AFC (monthly)</b>         | \$2,542 | \$4,222 | \$3,597 | \$4,012 | \$1,789 | \$2,335 |
| <b>Avg. Base Benefit</b>     | \$632   | \$661   | \$839   | \$550   | \$500   | \$396   |
| <b>Avg. Benefit Received</b> | \$332   | \$267   | \$472   | \$190   | \$263   | \$201   |

In general, the base benefit of those currently receiving a disability benefit was reduced by about 50 percent, meaning that the average member became disabled approximately seven years before full retirement eligibility.

The average disability retiree was relatively short-tenured, with under 13 years of service.



Based on age and member service, the average disability retiree was a mid-career hire.

This information should be interpreted with caution as it may simply be reflecting that point in a member's age and service at which it becomes worthwhile to take a disability retirement benefit in lieu of a lump-sum or return of contributions benefit.

### **History**

In the 2005 legislative session, the LEOFF 2 Board sponsored legislation that removed the actuarial reduction for duty-disability retirements. The legislation passed as Chapter 451, Laws of 2005.

In the 2004 legislative session, the LEOFF 2 Board sponsored legislation that created a minimum duty-disability retirement that provided a tax-free component to the existing LEOFF 2 duty-disability retirement benefit. This legislation passed as Chapter 4, Laws of 2004.

### **Washington State Systems and Plans**

Disability benefits in the Washington systems and plans are nearly as varied as the systems and plans themselves (see Figure 4). In general, public safety plans (LEOFF and WSPRS) have more generous disability provisions than the public employee, teacher, and school employee systems and plans.

The disability retirement benefits in LEOFF and WSPRS acknowledge the inherent danger associated with public safety occupations. It is understood that an injury that may not cause a significant impediment in a civilian job may reduce a peace officer's or firefighter's occupational effectiveness, possibly to the point of endangering the member, the public, or both. As a result, the threshold for an occupational disability is lower in LEOFF and WSPRS compared to the other systems and is reflected in their disability retirement benefits.

**Figure 4**  
**Disability Benefits by Washington System and Plan**

| <b>System/Plan</b>                       | <b>Benefit</b>   |
|--|--|
| <b>LEOFF 1</b>                           | Duty and Non-duty: 50% of Final Average Salary (FAS), plus 5% of FAS for each dependent child, not to exceed 60% of FAS.   |
| <b>LEOFF 2</b>                           | Non-duty: Earned benefit, actuarially reduced from age 53.<br>Duty: Earned benefit, not actuarially reduced.   |
| <b>WSPRS</b>                             | Duty: 50% of compensation earned at time of disability, less workers' compensation.<br>Non-duty: 50% of compensation earned at time of disability, less workers' comp., soc. sec., group insurance, or other pension plans. If member is less than age 50, earnings off-set is also applied. |
| <b>PERS 1</b>                            | $\frac{2}{3}$ AFC or \$4,200 per year, whichever is less. At age-60, benefit converts to service retirement allowance in which service credit is granted for the disability period. Offset by worker's comp.   |
| <b>TRS 1</b>                             | Temporary: Allowance of \$180/month for up to 2 yrs.<br>Permanent:<br>(1) Service retirement, if eligible; or<br>(2) Annuity based on member's contributions and service pension, if eligible; or<br>(3) Refund of member's contributions, plus accrued interest thereon.                    |
| <b>PERS, SERS, and TRS 2/3</b>           | Allowance based upon years of service.<br>Actuarially reduced from age-65.   |
| <b>PSERS</b>                             | Allowance based upon years of service,<br>Actuarially reduced from age-60.   |
| <b>Higher Education Retirement Plans</b> | The supplemental amount.<br>No actuarial reduction taken on account of age.  |
| <b>Volunteer Fire</b>                    | Total disability: \$2,550 per month or \$85 per day for a maximum of 6 months, then \$825 per month.   |
| <b>Judges, Judicial</b>                  | 50% of FAS for any member having 10+ yrs. of credited service.   |

(For a more complete description of Washington's disability benefits, see Appendix A).

## Comparative Systems

Among the comparative systems there is some consistency in regards to disability retirement benefits (see Figure 5). The one provision that tends to be most commonplace is the absence of an actuarial reduction in calculating either a duty or non-duty disability benefit. Other common features are benefits based on a fixed percentage of salary or benefits that would be assumed at a normal retirement age. There are also off-sets against a workers' compensation benefit. In general, the disability retirement benefits among the comparative systems are similar in value to service retirement benefits. For a more complete description of disability benefits and standards in these comparative systems see Appendix B.

**Figure 5**  
**Disability Benefits by Comparative System**

| <b>System</b>             | <b>Benefit</b>  |
|---------------------------|---|
| <b>California CalPERS</b> | Earned monthly retirement benefit for life or until recovered from injury.  |
| <b>Colorado PERA</b>      | 50% of Highest Average Salary or greater if accrued service credit is 20+ yrs.  |
| <b>Florida FRS</b>        | Regular: 25% of AFC<br>Duty: 42% of AFC<br>Special Risk: 65% of AFC   |
| <b>Idaho PERSI</b>        | Age 65 benefit or 30 yr. benefit, whichever is less for regular members.<br>Age 60 benefit or 30 yr. benefit, whichever is less for police and fire members.  |
| <b>Iowa IPERS</b>         | Earned benefit without reduction for early retirement.  |
| <b>Minnesota MSRS</b>     | Earned benefit without reduction for early retirement.<br>Workers' comp. benefit reduced by MSRS benefit.<br>LTD benefits may be reduced by MSRS benefit.   |
| <b>Missouri MOSERS</b>    | 60% of member's monthly salary on their last full day of active work or the average monthly salary for the highest 36 months of employment, less soc. sec., workers' comp., wages, other insurance, and sick leave. |
| <b>Ohio OPERS</b>         | Earned benefit with no reductions for early retirement.<br>Cannot be less than 45% or exceed 60% of FAS.  |
| <b>Oregon PERS</b>        | Age 58 retirement benefit for general service members.<br>Age 55 retirement benefit for police officers and firefighters.   |
| <b>Seattle SCERS</b>      | Earned benefit that is at least $\frac{1}{3}$ of the member's Average Salary.   |
| <b>Wisconsin WRS</b>      | Benefit assumed at normal retirement age – 65 for regular members and 55 of protective members.   |

### **Disability Standards**

Among the comparative retirement systems, the standard to define disability has a recurring theme – a persons' inability to perform his or her job duties. A secondary standard is the inability to perform any other job (see Appendix B). Iowa public employees must meet the Social Security or Railroad Retirement Board standard of disability in order to qualify for a state disability retirement benefit.

Disability standards also use various losses of earnings by which disability is measured, from “reasonably comparable pay and benefits” to specific percentages of pre-disability earnings (75 percent in Colorado, loss of 20 percent in Missouri, 60 percent in Wisconsin).

Another common element among the comparable systems is the immediate eligibility for receipt of a duty-disability. But among those systems that provide non-duty or “regular” disabilities there are a variety of length-of-service qualifying standards: Seattle and Oregon require ten years of service, Florida requires eight years, Idaho and Ohio require five years, and Minnesota requires three years.

### **Disability Utilization**

With the variety of disability benefits and standards, it would be useful to examine the frequency at which those benefits are used. Figure 6 provides data on the total number of retirees in the comparable systems and how many of those retirees receive a disability retirement benefit.

**Figure 6**  
**Total and Disability Retirees by Comparative Retirement System**

| <b>System</b>             | <b>Total Retirees</b> | <b>Disability Retirees</b> |        | <b>% Disability Retirees</b> |       |
|---------------------------|-----------------------|----------------------------|--------|------------------------------|-------|
| <b>California CalPERS</b> | 416,783               | Regular                    | 31,940 | Regular                      | 7.7%  |
|                           |                       | Industrial                 | 26,098 | Industrial                   | 6.3%  |
| <b>Colorado PERA</b>      | 68,197                |                            | 7,472  |                              | 11.0% |
| <b>Florida FRS</b>        | 224,813               |                            | 12,995 |                              | 5.8%  |
| <b>Idaho PERSI</b>        | 26,043                |                            | 998    |                              | 3.8%  |
| <b>Iowa IPERS</b>         | 76,961                |                            | 2,693  |                              | 3.5%  |
| <b>Minnesota MSRS</b>     | 22,654                |                            | 1,397  |                              | 6.2%  |
| <b>Missouri MOSERS</b>    | 24,757                |                            | 25     |                              | 0.1%  |
| <b>Ohio OPERS</b>         | 145,263               |                            | 19,758 |                              | 13.6% |
| <b>Oregon PERS</b>        | 98,686                | Duty                       | 633    | Duty                         | 0.6%  |
|                           |                       | Non-duty                   | 3,502  | Non-duty                     | 3.5%  |
| <b>Seattle SCERS</b>      | 3,994                 |                            | 73     |                              | 1.8%  |
| <b>Wisconsin WRS</b>      | 126,211               |                            | 6,346  |                              | 5.0%  |
| <b>Washington Plans</b>   | 104,805               |                            | 4,062  |                              | 3.9%  |

Despite the common themes found in the disability standards, the share of disability retirements to total retirements differs widely among the comparative retirement systems. The low percentage of disability retirement in Missouri may be a result of the workers' compensation and social security benefit off-sets. The high percentage of disability retirement in Colorado and Ohio may be due to the absence of Social Security coverage – state disability retirement policy may accommodate the lack of additional benefits.

## Other Disability Benefits

Plan 2/3 members' financial protection from disability is not limited to their earned retirement benefit. The following sections of this report will describe the alternate sources of disability benefits for Plan 2/3 members – Workers' Compensation, Long-Term Disability (LTD) insurance, and Social Security. These alternate sources of benefits are not necessarily independent of each other. Receipt of an earned disability retirement benefit is not subject to off-sets from these other sources of disability coverage, but receipt of workers' compensation or social security will off-set an LTD benefit.

## Workers' Compensation

### Time-Loss Benefits

Plan 2/3 members who are unable to work as a result of injury or disease incurred in the course of employment may be eligible to be paid a portion of their regular wages under Labor and Industry's (L&I) Workers' Compensation program. These time-loss compensation payments will not provide the same income as when the members were working. The amount of a time-loss benefit is 60 to 75 percent of a worker's gross income (includes wages/salary plus medical, dental, and vision benefits, room and board, bonuses, and tips). The percentage depends on the worker's marital status and number of dependents. On an annual basis these benefits cannot exceed 120 percent of the state's average wage as measured by the Washington State Employment Security Department; as of 2004 the State's annual average wage was \$38,794 and 120 percent of the annual average wage was \$46,553.

### Awards for Partial Permanent Disabilities

If an injury or occupational disease causes permanent loss of bodily function, the injured worker will receive a permanent partial disability award. The amount received for any physical loss is established by the Legislature and does not include compensation for pain and suffering. There are two types of permanent partial disabilities:

- *Specified disabilities* Some disabilities have awards that are already set by law, such as loss of vision or hearing, or the loss of an eye, leg, foot, toe, arm, or finger by amputation (see RCW 51.32.080).
- *Unspecified disabilities* These disabilities include every other type of impairment caused by an on-the-job injury or occupational illness, including the partial loss of function to a limb.

The degree of a partial loss of function is determined by a disability rating. These ratings are conducted either by the attending physician or by one or more independent medical examiners using established medical standards and guidelines. Normally, ratings are performed after all services have been completed, the injured worker is medically stable, and no further treatment is appropriate.

A permanent partial disability award is not jeopardized by working. Workers are encouraged to return to their job as soon as their doctor releases them for work. Any permanent partial disability award is based on the degree of damage suffered, not on whether an employee can work.

### **Pensions for Total Permanent Disabilities**

If an accident results in the loss or total paralysis of both legs or arms, one leg and one arm, or a total loss of eyesight, a worker is eligible for a pension by law, even if able to return to work.

If vocational and medical evaluations determine that an injury prevents a worker from ever becoming gainfully employed, they may be paid a monthly pension for life. However, this type of “non-statutory” pension may not be payable if a worker is able to return to work.

Pension benefits are paid monthly. They are based on the amount of time-loss compensation to which a worker is entitled. As with time-loss compensation benefits, the amount a worker is eligible to receive depends on factors such as wages, marital status, number of dependents, health care benefits, Social Security benefits, and the state’s average wage at the time of injury. In some cases, a pension benefit amount may be reduced for previously paid permanent partial disability awards.

### **Pension Survivor Options**

If a worker is granted an L&I pension, they can choose one of these survivor options:

- An unreduced single life pension.
- A reduced joint and 50 percent pension.
- A further reduced joint and 100 percent pension.

### **Tax Free**

Workers’ compensation benefits are tax-free. The actual value of a benefit will depend on the tax-status of the recipient. A recipient eligible for the maximum annual time-loss benefit of \$46,553, who had formerly been in the 28 percent tax bracket, would receive a benefit equivalent to \$64,657.

## **Long-Term Disability Insurance**

Eligible retirement plan members may protect themselves from a disabling injury outside the work-place by purchasing LTD insurance. This insurance is offered through the Public Employees Benefits Board (PEBB) in basic and optional coverage. Basic coverage provides up to \$240 per month while optional coverage, in combination with basic coverage, will pay 60 percent of the first \$10,000 of pre-disability monthly earnings. These payments continue for a maximum benefit period – in most cases, up to the age of 65 – the age of normal retirement. At the end of the maximum benefit period LTD payments cease and the member transitions to a normal retirement benefit with service credit normally awarded for the period of disability.

For members who are willing to wait 120 days before receiving benefits, the monthly premiums are 0.43 percent of pay for Higher Education Retirement Plan employees and 0.37 percent of pay for TRS, PERS, and other employees (see Appendix C). As is characteristic with disability insurance, shorter waiting periods have higher premiums and longer waiting periods have lower premiums. A note of caution – not all PERS members are eligible for PEBB coverage.

If a member has LTD insurance and is injured on the job, their LTD benefits are off-set against workers' compensation.

## **Social Security Disability**

Most Plan 2/3 members pay into the Social Security system and are covered under the system's disability provisions. The definition of disability under Social Security, however, is quite narrow. Social Security pays only for a total disability where an individual is completely unable to work. No benefits are payable for partial disability or for short-term disability. An individual is considered disabled under Social Security rules if they cannot do work they did before and they cannot adjust to other work because of their medical condition(s). An individual's disability must also last, or be expected to last, for at least one year or to result in death.

This is a strict definition of disability. Social Security program rules assume that working families have access to other resources to provide support during periods of short-term disabilities, including workers' compensation, insurance, savings, and investments.



### **Social Security Standard for Disability**

Those applying for a Social Security disability benefit are evaluated via a progressive series of questions beginning with...

... *Are they working?* Those currently working and earning more than \$811 a month generally are not disabled. For those not working...

... *Is their condition "severe"?* A condition must interfere with basic work-related activities to be a disability. If it does not, there is no disability. If it does...

... *Is their condition on the list of disabling conditions?* Social Security maintains a list of medical conditions that automatically mean a worker is disabled. If the condition is not on the list, Social Security determines if it is of equal severity to a condition on the list. If it is, the worker is disabled. If it is not...

... *Can they do the work they did previously?* If the condition is severe, but not at the same or equal level of severity as a medical condition on the list, then Social Security determines if it interferes with their ability to do the work they did previously. If it doesn't, the claim will be denied. If it does...

... *Can they do any other type of work?* If they cannot adjust to other work, their claim will be approved. If they can adjust to other work, their claim will be denied.

### **How Much Work Is Needed?**

In addition to meeting the Social Security definition of disability, a worker must have worked long enough, and recently enough, to qualify for disability benefits. Social Security work credits are based on total yearly wages or self-employment income. Up to four credits can be earned each year. The amount needed for a credit changes from year to year. For 2005, \$920 of wages will earn one credit and \$3,680 of wages will earn the maximum four credits.

The number of work credits needed to qualify for disability benefits depends on the age of disability. Generally, a worker needs 40 credits, 20 of which were earned in the last ten years ending with the year they become disabled. However, younger workers may qualify with fewer credits.

## Policy Analysis

Unlike funding policy, which is found in statute, disability policy can only be inferred through existing provisions. Those provisions treat disability pensions in the Plans 2/3 similar to early retirement benefits rather than insurance benefits. Within the confluence of public employee programs, it is understood that plan members are covered under Washington State's industrial insurance program and also have at their disposal, should they so choose, LTD insurance. As a result, there is less of a need to provide similar insurance-type coverage under the retirement plans themselves.

Plan 2/3 members who are injured on the job are covered by the workers' compensation program administered by L&I. In a situation where a retirement plan member is disabled because of an injury that occurred away from work, and thus not covered under workers' compensation, current provisions require that members be responsible for the purchase of LTD insurance through PEBB. As local government employees are not eligible for PEBB benefits, their employers' ability to offer them LTD insurance coverage has to be considered separately from the state.

Most Plan 2/3 members are also covered under the Federal Social Security program. In addition to providing retirement benefits, this program also provides disability benefits. Admittedly the qualifying standards to receive these benefits is very high -- to qualify, a recipient must be unable to perform any gainful employment.

Thus, the current policy towards disability acknowledges that a member's financial needs are only partially addressed through the retirement systems via the disabled member's earned early retirement benefit. It is understood that the remaining financial protection is provided through workers' compensation, LTD insurance (that the member must choose to purchase), and Social Security benefits.

## Policy Questions

In light of the questions regarding the adequacy of Plan 2/3 disability retirement benefits, the distinct sources of disability benefits available for public employees, and the inter-relationship of those sources and benefits, SCPP members may want to consider the following policy questions:

- Should worker disability issues be addressed outside or within the retirement plans?
- Should the retirement plans provide disability insurance kinds of benefits?
- Should the retirement plans make distinctions between duty and non-duty disabilities?
- Should payment of LTD insurance premiums be a member responsibility, an employer responsibility, or a shared responsibility?
- Should any disability benefit improvement be retroactive (benefit issues are invariably considered after the fact)?
- Should the retirement systems make distinctions between public safety and non-public safety disability benefits?

### **Options for Plan 2/3 Disability Retirement**

**Option 1.** *Eliminate the actuarial reduction for a disability retirement.*

This would place the PERS, SERS, and TRS Plans 2/3 on par with LEOFF 2 and acknowledge the involuntary nature of disability.

**Option 2.** *Eliminate the actuarial reduction for a total disability retirement only with off-sets for workers' compensation.*

This would acknowledge the financial needs of members who are unable to work while recognizing their L&I coverage.

**Option 3.** *Eliminate the actuarial reduction for a duty-disability retirement only.*

This would require an administrative differentiation between a duty and non-duty disability; at this time no such administrative difference is made.

**Option 4.** *Eliminate the actuarial reduction for a duty-disability with off-sets for workers' compensation.*

This would acknowledge the benefits available outside the retirement system and require the same administrative burden as option 2, plus require additional coordination with L&I.

**Option 5.** *Lower the reduction for a disability retirement to 3 percent per year.*

This would acknowledge the involuntary nature of disability and still recognize the need for members to provide their own insurance coverage.

**Option 6.** *Lower the reduction for a duty-disability retirement to 3 percent per year only.*

This would acknowledge the involuntary nature of disability while recognizing that members may be not be eligible for a total and permanent workers' compensation or Social Security disability benefit.

**Option 7.** *Lower the actuarial reduction for a duty-disability to 3 percent per year with off-sets for workers' compensation.*

This would acknowledge the involuntary nature of disability while also recognizing that the duty disabled may be receiving workers' compensation benefits.

**Option 8.** *Default new retirement system members into LTD coverage – they would need to affirmatively decide to opt-out of coverage.*

This would recognize that the member has the primary responsibility for their own non-duty disability insurance coverage.

**Option 9.** *Provide an employer subsidy for LTD coverage.*

This would recognize that while the member has the primary responsibility for non-duty disability insurance coverage, it is also in the employers' interest to assure their employees are financially secure.

### Stakeholder Inputs

Jeffrey Graves (see attachment)

George A. Compton, c/o Representatives Fromhold and Crouse (see attachment)

### Next Steps

The Executive Committee of the SCPP will examine the options and decide whether to forward a proposal to the full committee or defer further study until the 2006 interim.

## **Appendix A**

### **Disability Benefits by Washington State Systems and Plans**

#### **LEOFF 1**

Duty/Non-Duty: With the approval of the local disability board and the Director, DRS, a member who has incurred a disability rendering him or her unable to continue service in the position or rank held at that time, shall receive an allowance of 50 percent of FAS, plus an additional 5 percent of FAS for each dependent child, not to exceed a maximum benefit of 60 percent of FAS.

#### **PERS 1**

Duty: From the time of disability to age 60, a member who becomes totally and permanently incapacitated as the result of an accident in the actual performance of duties, or qualifies to receive workers' compensation benefits (Industrial Insurance) due to an occupational disease, shall receive an allowance of  $\frac{2}{3}$  AFC or \$4,200 per year, whichever is the lesser. At age 60, the benefit converts to a service retirement allowance in which service credit is granted for the period from the date of disability to the date of conversion to the service retirement. This benefit is offset by workers' compensation.

If a disabled member becomes gainfully employed and the compensation received is less than the compensation received at the time of becoming disabled (adjusted by the CPI-Seattle), the disability benefit is to continue, but it is reduced so the sum of the benefit and the new compensation are equal to the compensation received at the time of disablement.

Non-duty: If the member has five or more years of service, the retirement allowance is reduced 2 percent for each year the member is under age 55. The benefit is offset by workers' compensation, if any.

## **TRS 1**

Temporary: An allowance of \$180 per month is payable to a member who is mentally or physically incapacitated for the further performance of duty for up to two years.

Permanent: A member who is employed either full-time or half-time under an annual contract but becomes totally and permanently incapacitated for duty is eligible for a benefit of:

- (1) A service retirement allowance based on service or age, if eligible; or
- (2) A disability retirement allowance, if eligible; or
- (3) A refund of the member's contributions, plus accrued interest thereon.

## **WSPRS 1 and 2**

Duty: 50 percent of compensation earned at time of disability, less any benefit received from workers' compensation.

Non-duty: 50 percent of compensation earned at time of disability, less benefits received from workers' compensation, social security, group insurance, or other pension plans. If the member is less than age 50, an earnings off-set is also applied.

Both duty and non-duty benefits are paid from the operational funds of WSP.

## **LEOFF 2**

- (1) A member who becomes totally incapacitated for continued employment shall receive an allowance based upon service credit years and shall have such allowance actuarially reduced from age 53.
- (2) A member who becomes disabled in the line of duty on or after January 1, 2001, is eligible to receive either:
  - (a) A refund of 150 percent of the member's accumulated contributions; or
  - (b) A minimum benefit equal to 10 percent of the member's AFC, plus an additional allowance of 2 percent of AFC for each year of service beyond five years. Ten percent minimum is tax-exempt.

**PERS 2, SERS 2, TRS 2**

A member who becomes totally incapacitated for continued employment shall receive an allowance based upon years of service and actuarially reduced from age 65.

**PSERS**

A member who becomes totally incapacitated for continued employment shall receive an allowance based upon years of service and actuarially reduced from age 60.

**PERS 3, SERS 3, TRS 3**

A member who becomes totally incapacitated for continued employment shall receive an defined benefit allowance based upon service credit years and actuarially reduced from age 65.

**Higher Education Retirement Plans**

If it is determined that the member is disabled due to a condition of health, the member is eligible for retirement. If the member has ten or more years of credited service, the member, regardless of age, may be entitled to the supplemental amount, except no actuarial reduction will be taken on account of age.

**Volunteer Firefighters' and Reserve Officers' Relief and Pension**

Beginning July 1, 2001, disability payments are increased annually by the two-year average increase in the CPI for urban wage earners and clerical workers, all items.

- (1) If it is determined that the member is physically or mentally disabled, as the result of the performance of duty, so as to be wholly prevented from engaging in every duty of the member's regular employment, the member will receive \$2,550 a month, not to exceed six months; or \$85 per day for periods of time less than one month.
- (2) The member may receive \$825 per month as long as the disability

continues if the member is either:

- (a) Incapacitated to the extent that he or she cannot engage in any occupation or perform any work for compensation or profit; or
  - (b) After October 1, 1978, sustained an injury resulting in the loss or paralysis of both legs or arms, or one leg and one arm, or total loss of eyesight, but is not prevented from engaging in any occupation or performing any work for compensation or profit. If the member has a spouse, an additional \$225 per month will be provided and/or \$110 for each child under the age of 18, to a maximum of \$2,550.
- (3) Where a permanent partial disability exists, the board may provide a lump sum payment as is paid under workers' compensation in lieu of monthly payments.

### **Judges, Judicial**

Fifty percent of FAS for any member having ten or more years of credited service and who is declared to be physically or otherwise permanently incapacitated for full and efficient performance of duty.



## Appendix B

### Disability Standards and Benefits in Comparative Systems

| System                    | Disability Standard  | Benefit  |
|---------------------------|--|--|
| <b>California CalPERS</b> | Illness or injury that prevents member from performing job duties with current employer or any other CalPERS employer.<br>No positions reasonably comparable in pay, benefits, and promotional opportunities that member can perform.  | Earned monthly retirement benefit for life or until recovered from injury.   |
| <b>Colorado PERA</b>      | Totally and permanently disabled from engaging in any regular and substantial gainful employment (75% of pre-disability earnings).   | 50% of Highest Average Salary or greater if accrued service credit is 20 + years.  |
| <b>Florida FRS</b>        | Totally and permanently disabled to the extent that they are unable to work.<br>(Regular disability requires 8 yrs. service, duty, or special risk eligibility from the first day.)  | Regular: 25% of AFC<br>Duty: 4 2% of AFC<br>Special Risk: 65% of AFC   |
| <b>Idaho PERSI</b>        | A physical or mental impairment that is considered total and permanent - prevents member from earning a livelihood.<br>(Regular disability requires 5 yrs. service, duty eligibility from the first day.)  | Age 65 benefit or 30 yr benefit, whichever is less for regular members.<br>Age 60 benefit or 30 yr. benefit, whichever is less for police and firefighters.                                    |
| <b>Iowa IPERS</b>         | Member is receiving soc. sec. disability or Railroad Retirement disability benefits.   | Earned benefit without reduction for early retirement.   |
| <b>Minnesota MSRS</b>     | Member has 3 or more yrs. service.<br>Is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that has existed or is expected to continue for a period of at least 1 year.   | Earned benefit, no reduction for early retirement.<br>Workers' comp. benefit reduced by MSRS benefit.<br>LTD benefits may be reduced by MSRS benefit.  |
| <b>Missouri MOSERS</b>    | LTD coverage provided at no cost to member.<br>Own occupation: Unable to perform with reasonable continuity the material duties of own occupation and loss of at least 20% of pre-disability earnings.<br>Any occupation: Unable to perform the material duties of any occupation – one that they could earn at least 60% of their pre-disability earnings in. | 60% of member's mon. salary on last full day of active work, or average mon. salary for highest 36 mos. of employment, less soc. sec., workers' comp., wages, other insurance, and sick leave. |
| <b>Ohio OPERS</b>         | 5 yrs. service credit (immediate eligibility for law enforcement), permanent disabling condition, either mental or physical, that prevents member from doing their job.  | Earned benefit with no reductions for early retirement, cannot be less than 45% or exceed 60% of FAS.  |

## Select Committee on Pension Policy

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|                          |  |  |
|--------------------------|--|--|
| <b>Oregon<br/>PERS</b>   | Member unable to perform any work that they are qualified for a min. of 90 consecutive days because of injury or illness.<br>Duty: Eligible immediately<br>Non-duty: 10 yrs. service.  | Age 58 retirement benefit for general service members.<br>Age 55 retirement benefit for police and firefighters. |
| <b>Seattle<br/>SCERS</b> | Non-duty: Unable to work due to illness and have at least 10 yrs. service, 5 that must have been earned during the 10 yrs. prior to disablement.<br>Duty: If, due to on-the-job injury, member is permanently and totally disabled, regardless of length of service. | Earned benefit that is at least 1/3 of member's AFS.   |
| <b>Wisconsin<br/>WRS</b> | Total and permanent disability, confirmed by 2 physicians, that prevents member from any further gainful employment (60% of final average earnings.)<br>Plan assumes member would also qualify for soc. sec. disability benefit.                                     | Benefit assumed at normal retirement age – 65 for regular members, 55 for protective members.                    |

## **Appendix C**

### **Public Employees Benefits Board Long Term Disability Insurance**

(Underwritten by Standard Insurance Company)

The PEBB-sponsored LTD plan has two parts—Basic and Optional.

**Basic Plan:** This plan is included in the full PEBB package at no additional cost for employees. The Basic Plan provides a benefit of 60 percent of the first \$400 of pre-disability earnings, reduced by any deductible income. The maximum benefit payable is \$240 per month. The minimum benefit is \$50 per month. Benefits begin after 90 days of total disability or after the period of accumulated sick leave, whichever is longer, and continue during disability up to the Maximum Benefit Period. The Maximum Benefit Period is determined by the type of disability and the age of the enrollee when he or she becomes disabled.

**Optional Plan:** This plan allows most employees eligible for the Basic Plan to apply for additional benefits. If the coverage is applied for within 31 days of the eligibility date, the member doesn't need to provide evidence of insurability. When combined with the Basic Plan benefits, the Optional Plan will pay 60 percent of the first \$10,000 of your pre-disability monthly earnings, reduced by any deductible income. The minimum combined benefit is \$100 per month. The Optional Plan benefit will increase in accordance with the Cost of Living Adjustment (COLA) provision. Optional Plan benefits begin after the end of the Benefit Waiting Period and continue during disability up to the Maximum Benefit Period -- in most cases up to the age of 65.

| <b>Payroll Deductions as a Percent of Pre-disability Earnings</b> |                                   |                                       |
|---|-----------------------------------|---------------------------------------|
| <b>Waiting Period</b>   | <b>Higher Education Employees</b> | <b>TRS, PERS, and Other Employees</b> |
| <b>30 days</b>  | 2.67%                             | 2.11%                                 |
| <b>60 days</b>  | 1.35%                             | 1.12%                                 |
| <b>90 days</b>  | 0.74%                             | 0.61%                                 |
| <b>120 days</b>   | 0.43%                             | 0.37%                                 |
| <b>180 days</b>   | 0.32%                             | 0.29%                                 |
| <b>240 days</b>   | 0.31%                             | 0.28%                                 |
| <b>300 days</b>   | 0.29%                             | 0.26%                                 |
| <b>360 days</b>   | 0.28%                             | 0.25%                                 |

To calculate an Optional Plan LTD premium, multiply the monthly base pay (up to \$10,000) by the percentage shown for the desired Benefit Waiting Period.

**Examples:**

For a Higher Education Retirement Plan (TIAA-CREF) employees with monthly earnings of \$1,000, the 60-day benefit waiting period would cost \$13.50 per month ( $1.35\% \times \$1,000 = \$13.50$ ).

For a TRS, PERS, or other retirement plan employee with monthly earnings of \$1,000, the 60-day benefit waiting period would cost \$11.20 per month ( $1.12\% \times \$1,000 = \$11.20$ ).



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Olympia, WA 98504-0438

**Senator Jean Berkey**  
38th Legislative District

Ph: (360) 786-7674  
FAX: (360) 786-7450  
Berkey\_Je@leg.wa.gov

July 21, 2005

Jeffry Graves  
730 Bair Island Road #101  
Redwood City, CA 94063

Dear Mr. Graves:

Thank you for your e-mail message of July 7, concerning your disability retirement benefits. I am sorry for the delay in responding, our Olympia office was closed for a short vacation.

In order for me to check into the specifics of your situation I will need a signed statement from you authorizing this office to review your personnel/retirement records. And, I will need the name of which Retirement Plan you were covered by the Port of Seattle. Please include your full name, social security number or employee number, date of birth and any other pertinent personal information along with the type of disability you incurred and if it was an injury covered by Labor and Industries.

I may also need to contact your employer, so please include a sentence that would allow me to make inquiries on your behalf.

I am including a self-addressed stamped envelope for your convenience.

Sincerely,

Jean Berkey  
State Senator  
Thirty-Eighth District

JB:ja

7/26/05

Dear Senator Berkey and Members of the Select Committee on Pension Policy,

This letter is in response to your request for information about my situation.

My retirement plan is with the Washington State Retirement System, PERS II. My Social Security number is [REDACTED] and the full spelling of my name is Jeffry Allan Graves.

I was with the Port of Seattle for 26 years. I was injured in a car accident off the job and have severe median nerve damage in my right arm. My right arm and hand are half numb and I have severe constant pain in both the arm and hand. This is not covered by Labor and Industries. I also have degenerative disc disease in my spine and a herniated disc C-6 & C-7 in my neck. These are secondary to the nerve damage in my right arm.

The herniated disc did happen on the job in 1990 and that case was closed even though I still have pain from that injury. I did not think at the time that the pain would return and that I would have trouble with it for the rest of my life. I tried to reopen this case at one point but I was denied by Labor and Industries Doctors. I got so tired of trying to deal with them, I just quit trying! My Doctors say that I am in very bad shape for a 52 year old man!

Here is the problem in a nutshell. I had to quit working because of my disability and filed for disability retirement benefits the Washington State Retirement System under PERS II. My reduced benefit is \$593.00 a month! There is no provision for someone injured off the job to collect full disability retirement benefits under PERS II like there is under LEOFF II. They removed the actuarial reduction for disability retirement for its members. That Legislation passed as chapter 451, Laws of 2005.

You might say, well I can collect Social Security Disability Benefits and Disability benefits under the Port group disability insurance policy. While this may be true, so can LEOFF II and any person retiring for a disability, wither they are getting full retirement benefits or not.

I have applied for both, but they both have different requirements for a disability and I can be denied even though the Washington State Retirement System approved benefits for my disability. I am still waiting to hear from both of them.

I would like you to consider removing the actuarial reduction for disability retirements for PERS II members. It only seems fair. I wish I could be at the meeting so you could actually see me and what I am going through, but my finances are limited. I reside in California now to be near my Family.

Regards,

  
Jeffry Allan Graves


cc: Select Committee on Pension Policy

## DISABILITY ACTION SHEET

RE: JEFFRY GRAVES

Jeffry Graves, [REDACTED] has applied for *Earned* disability retirement allowance. The application has been reviewed, and it administratively meets statutory requirements in accordance with RCW 41.40.670.

Comments:

  
Cathy Dodson

6/30/05  
(Date)

Separation Date:

PERS/SERS Retirement Services Analyst

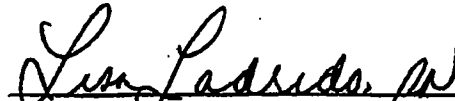
\*\*\*\*\*

Jeffry Graves, [REDACTED] is a 52-year-old PERS-2 Port of Seattle Harbor Facilities coordinator who has applied for *Earned* disability retirement allowance. He reports permanent median nerve damage in right arm and hand, severe chronic pain, sensory loss, arm and hand weakness, herniated disc at C-6-7 and neuropathy. The member reports additional employment skills to include marina attendant. Mr. Graves has not separated from employment.

The *Employer* supports the application. They explored reasonable accommodation to include leave, which began on 05/24/2005-07/12/2005. No additional accommodations were offered due to the fact that Mr. Graves' essential functions could not be sufficiently modified. It is their opinion that Mr. Graves can no longer perform the duties of the position due to nerve damage and pain.

Thomas B. Curtis, MD (*Physical Medicine and Rehabilitation*) reports cervical degenerative disc disease, proximal right median neuropathy, decreased function caused by pain. Mr. Graves presents with pain, decreased function and strength. MRI is consistent with cervical degenerative disc disease, right C6-7 foraminal narrowing and on 06/22/2003 underwent surgical exploration of the median nerve, however pain persisted. Dr. Curtis concludes Mr. Graves became totally incapacitated for further performance of duty 05/24/2005. (I)

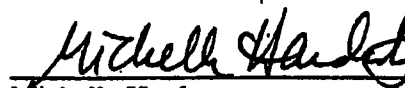
Comments: Recommend *approval*.

  
Lisa Ladrido, RN, BSN  
Medical Advisor

6/30/2005  
(Date)

\*\*\*\*\*  
According to the authority delegated by the Director under the provisions of RCW 41.50.060, the above-noted application is *approved / denied*.

Comments:

  
Michelle Hardesty  
PERS/SERS Plan Administrator

6/30/05  
(Date)

STATE REPRESENTATIVE  
4th DISTRICT  
LARRY CROUSE

State of  
Washington  
House of  
Representatives

TECHNOLOGY,  
TELECOMMUNICATIONS & ENERGY  
RANKING MINORITY MEMBER  
COMMERCE & LABOR



RECEIVED

JUL 5 2005

Office of  
The State Actuary

June 30, 2005

Representative Bill Fromhold  
PO Box 40600  
Olympia, Washington 98504-0600


Dear Representative Fromhold:

*Bill*

Attached is a letter I received from, George Compton, a disabled veteran living in Spokane. Mr. Compton is requesting changes in early retirement pension rules for those who have sustained military service related disabilities. I'm not sure if Mr. Compton has contacted other SSCP members, but I wanted to make sure that you were aware of his concerns.

Please let me know if you think this is an issue that may merit further consideration by the committee.

Best regards,

  
Larry Crouse  
State Representative  
District 4

LC/ss

enc. Letter of George Compton



January 31, 2006

Representative Larry Crouse  
Select Committee on Retirement Policy

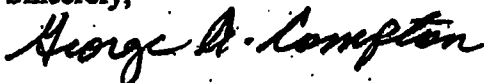
Hello, my name is George Compton, and I am a resident of Washington state legislative district 6. Let me begin by telling you that I am 56 years old and was employed by the Department of Social and Health Services (DSHS) for just short of 24 years, the last 17 years as a social worker with Home and Community Services (HCS).

In October 2004, I voluntarily terminated my employment after it became apparent that I was no longer able to adequately perform my job duties. This was not an easy decision for me to make, but, due to the circumstances, I believe this decision was the wisest and fairest one possible for the department, the clients I served, and myself. I was drafted and sent to Vietnam as infantry in 1967. I was injured by a land mine explosion and suffered fractures to both ankles as well as my spine. I now have Degenerative Joint Disease in these joints and experience chronic (and sometimes severe) pain. I also have Post Traumatic Stress Disorder (PTSD) and since the events of September 11, 2001, this condition has increased in severity to the point that I am not able to function well enough to maintain employment. I have been awarded a disability pension from the Veterans' Administration, but this is less than a third of what I had been earning as a social worker. I qualify for retirement benefits from the State of Washington, but due to my age and the rules concerning actuarial reduction in these pension benefits for being under age 65, I would not receive much. This is where I am hoping you could help me.

I am requesting that you work with your fellow legislators to make needed changes to the rules governing the State Public Employees Retirement System. Veterans who have suffered severe service-connected disabilities while serving their country and are no longer able to maintain employment due to these disabilities should be entitled to receive the retirement benefits they have earned without having them actuarially-reduced.

Right now there are men and women from this state serving our country in Iraq and Afghanistan. Some of them were called up from the Reserves or National Guard and may be State Employees. If they are injured while serving and are unable to return to work, should they have to wait until they are 65-years old to receive their retirement benefits without being penalized by the actuarially-reduced amount? Is that how this state is going to tell them "Thank you for your sacrifice"? I did not get a "Thank You" when I came home from Nam. In fact I came home to ridicule and contempt. I hope that these men and women are treated much, much better. Now, at age 56, I am unable to work as a consequence of my serving this country. Is it asking too much to get my retirement without the actuarial penalty? Can this state finally tell me and my fellow (state employee) veterans "thank you" by allowing us to retire with dignity under these less than ideal circumstances? Thank you for your consideration.

Sincerely,



George A Compton  
3624 N. Garfield Rd.  
Spokane, WA. 99224  
(509)244-9457  
georgecompton@highstream.net

MESSAGE:

Dear Senator Fraser,

Greetings! I realize that I am not in our legislative district, but as you are the Chair for the Select Committee on Pension Policy I believed that it would be appropriate to contact you, but perhaps I am mistaken. I am a disabled Vietnam Veteran who has worked for the State of Washington for almost 24 years. I was forced to resign my position as a social worker

Oct. as a result of my service connected disabilities. I tried my best to overcome these disabilities and continue to work with the goal of retiring at age 65, however, my health became such an issue that I was not able to adequately perform job duties and I was finally forced to resign. On Jan. 31, 2005, I mailed you a letter regarding this situation but I do not believe that I received any response from you which would indicate that you received it. I will include a copy of this letter with this email so that you may see it if it was misdirected in the mail. I hope to receive a response from you in the near future. Thank you!

The following is a copy of the letter I sent on Jan. 31, 2005.

January 31, 2006

Dear Senator Fraser,

Hello, my name is George Compton, and I am a resident of Washington state legislative district 6. Let me begin by telling you that I am 56 years old and was employed by the Department of Social and Health Services (DSHS) for just short of 17 years, the last 17 years as a social worker with Home and Community Services (HCS).

In October 2004, I voluntarily terminated my employment after it became apparent that I was no longer able to adequately perform my job duties. This was not an easy decision for me to make, but, due to the circumstances, I believe this decision was the wisest and fairest one possible for the department, the clients I served, and myself. I was drafted and sent to Vietnam as infantry in 1967. I was injured by a land mine explosion and suffered fractures to both ankles as well as my spine. I now have Degenerative Joint Disease in these joints and experience chronic (and sometimes severe) pain. I also have Post Traumatic Stress Disorder (PTSD) and since the events of September 11, 2001, this condition has increased in severity to the point that I am not able to function well enough to maintain employment. I have been awarded a disability pension from the Veterans' Administration, but this is less than a third of what I had been earning as a social worker. I qualify for retirement benefits from the State of Washington, but due to my age and the rules concerning actuarial reduction in these pension benefits for being under age 65, I would not receive much. This is where I am hoping you could help me.

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Right now there are men and women from this state serving our country in Iraq and Afghanistan. Some of them were called up from the Reserves or National Guard and may be State Employees. If they are injured while serving and are unable to return to work, should they have to wait until they are 65-years old to receive their retirement benefits without being penalized by the actuarially-reduced amount? Is that how this state is going to tell them "Thank you for your sacrifice"? I did not get a "Thank You" when I came home from Nam. In fact I came home to ridicule and contempt. I hope that these men and women are treated much, much better. Now, at age 56, I am unable to work as a consequence of my serving this country. Is it asking too much to get my retirement without the actuarial penalty? Can this state finally tell me and my fellow (state employee) veterans "thank you" by allowing us to retire with dignity under these less than ideal circumstances? Thank you for your consideration.

Sincerely,

George A Compton  
3624 N. Garfield Rd.  
Spokane, WA. 99224  
(509)244-3236  
jorgecompton@highstream.net



## Accounting for Post-Retirement Medical Benefits

Select Committee on Pension Policy  
October 18, 2005



Philip Martin McCaulay, FSA, EA, MAAA  
Senior Pension Actuary

### Post-Retirement Medical Benefits

- ❖ OPEB - Other Post-Employment Benefits.
- ❖ Benefits other than pensions.
- ❖ Medical, prescription drug, dental, vision.
- ❖ Life, disability, long-term care.
- ❖ Standards for accounting for OPEB set by GASB.

## GASB

- ❖ Governmental Accounting Standards Board.
- ❖ Sets standards for state and local governmental accounting and financial reporting.
- ❖ Guides and educates the public, including issuers, auditors, and users of those financial reports.

## GASB Statement No. 12

- ❖ Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers.
- ❖ Current standard.
- ❖ Pay-as-you-go basis.
- ❖ GASB 12 superseded by GASB 45.

## GASB Statement No. 45

- ❖ Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.
- ❖ GASB 45 (OPEB) similar to GASB 27 (pension).
- ❖ Recognizes actuarial cost of projected OPEB liabilities.

## GASB 45 Impact

- ❖ GASB 45 disclosure of OPEB liabilities.
- ❖ Impacts financial statements of employers (state, counties, and cities).
- ❖ Impacts former employers of LEOFF Plan 1 retirees.

## Current Situation

- ❖ Example of OPEB liability: Public employers providing subsidized retiree medical premiums.
- ❖ Medical inflation outpacing general inflation.
- ❖ Increasing premiums for retirees diminishes purchasing power.
- ❖ Liabilities currently not pre-funded.

## GASB 45 Issues

- ❖ Funded status will be disclosed in financial statements starting in 2007.
- ❖ Bond rating agencies reviewing liabilities and strategies for managing costs.
- ❖ Lack of action to manage cost could negatively impact bond ratings.
- ❖ Effect of negative impact on ratings is an increased cost of borrowing.

## Current Benefit Policy

- ❖ Access to employer-provided group medical insurance after retirement.
- ❖ No pre-funded medical coverage.
- ❖ LEOFF 1 is pay-as-you go.
- ❖ State, K-12, and Higher-ed retirees may participate at subsidized rates.

## LEOFF 1 Retiree Medical

- ❖ LEOFF 1 retirees receive retiree medical benefits.
- ❖ Employers pay full medical costs before and after age 65.
- ❖ A significant number of LEOFF 1 retirees are not covered by Medicare.

## Retirees in PEBB

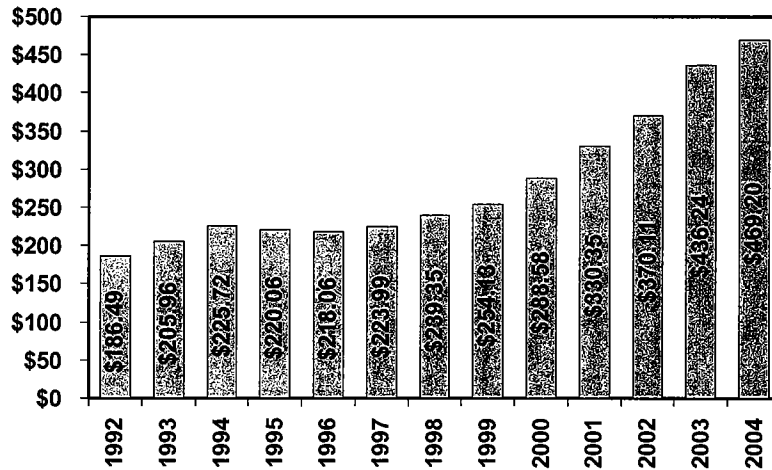
- ❖ Public Employees Benefits Board (PEBB).
- ❖ State, K-12, and higher education employees may continue in PEBB after retirement.
- ❖ Retirees pay active member PEBB premium before age 65.
- ❖ The state pays part of the PEBB premium after age 65.

## PEBB Premiums from HCA

- ❖ Health Care Authority (HCA).
- ❖ 2006 blended premium:
  - Non-Medicare subscriber - \$689.38/month.
- ❖ 2006 Medicare retiree rate:
  - \$458.17 / mo. total claim cost.
  - \$131.87 / mo. is subsidized.
  - \$326.30 / mo. retiree premium.



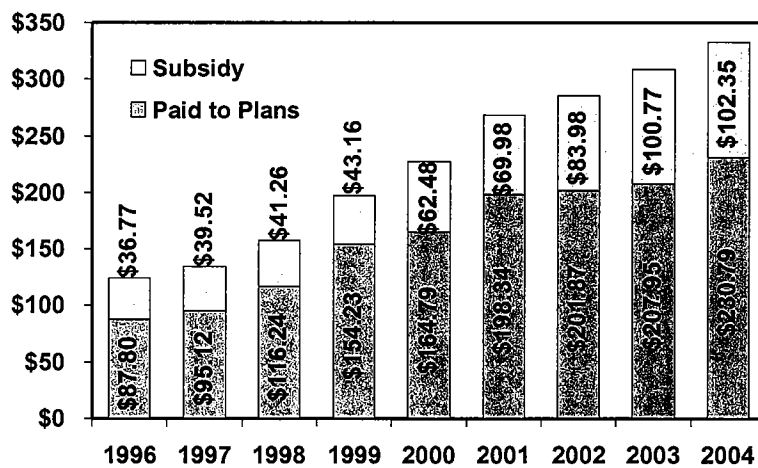
### Average Monthly PEBB Premium Paid by Pre-Medicare Retirees



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12

### Average Monthly PEBB Premium Paid by Medicare Retirees and Subsidy



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13

## Explicit and Implicit Subsidies

- ❖ Explicit subsidy: The employer pays part of the cost.
- ❖ Implicit subsidy: The rate charged is a blended rate.
- ❖ A blended rate is less than the rate that would apply to the retirees only.
- ❖ Both types of subsidies have a cost that must be accounted for under GASB 45.

## Explicit and Implicit Subsidies

- ❖ Medicare retirees in PEBB:
  - Explicit subsidy of \$131.87 per month.
- ❖ Non-Medicare retirees in PEBB:
  - 50 percent higher risk factor than actives.
  - Implicit subsidy of about 50 percent of blended rate of \$689.71 / month.

## Sample 2006 PEBB Claim Costs

| Retiree             | Claims                          | Premium                         | Subsidy                         |
|---------------------|---------------------------------|---------------------------------|---------------------------------|
| <b>Pre-Medicare</b> | \$1,064/mo<br>risk-<br>adjusted | \$689/mo<br>blended<br>premium  | \$375/mo<br>implicit<br>subsidy |
| <b>Medicare</b>     | \$458/mo<br>experience<br>rated | \$326/mo<br>experience<br>rated | \$132/mo<br>explicit<br>subsidy |

## Current Subsidies Will Increase

- ❖ Medical inflation is assumed to start high and come down.
- ❖ Short term medical inflation around 10 percent to 15 percent.
- ❖ Long-term medical inflation more in line with general inflation.
- ❖ Inflation on prescription drug costs higher.

## Impact on Financial Statements

- ❖ 2003-2005 subsidy for retirees in PEBB about \$223 million.
- ❖ GASB 45 expense about 5 to 10 times the pay-as-you-go cost.
- ❖ Expense depends on whether benefits are prefunded or not.
- ❖ Funding policy determines allowable discount rate.

## Discount Rate for GASB 45 Liabilities

- ❖ GASB discount rate may be between 7 percent and 8 percent if benefits are prefunded.
- ❖ Likely 2 percent to 5 percent if pay-as-you-go.
- ❖ Lower discount rate increases GASB liability.
- ❖ GASB liability could impact bond ratings.

## Impact on Bond Ratings

- ❖ Bond rating agencies (Standard & Poor's and Fitch Ratings) will use GASB 45 information.
- ❖ Part of ongoing analytical surveillance of ratings.
- ❖ Close attention will be paid to OPEB liabilities and strategies for managing them.
- ❖ Lack of action to manage cost will be a negative factor.

## Strategies for Managing Liabilities

- ❖ Health Care Authority (HCA) strategies to hold back rising health care costs.
  - Smarter health care consumers.
  - Better manage care for high cost services and treatments.
  - Purchase collectively with other large employers.
  - Seek higher quality standards from plans and providers.

## Next Steps for State, Counties, and Cities

- Quantify GASB 45 liability and have actuarial valuations done at least biennially.
  - HCA / OFM.
- Determine funding policy.
  - Legislature.
- Develop strategies for managing liabilities.
  - Legislature / HCA.
- Discuss with bond rating agencies.
  - Treasury / OFM / OSA/ DRS.

# Select Committee on Pension Policy

## Accounting for Post-Retirement Medical Benefits

*(October 12, 2005)*

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### **Issue**

Increasing health insurance premiums for retirees can diminish the purchasing power of their retirement benefits. As a result, the cost of retiree health benefits is a growing concern to public employers. Beyond the cost and adequacy of retiree health benefits, employers are facing new concerns related to accounting for those retiree health costs. Public employers are required to disclose the costs of these benefits under new accounting rules set by the Governmental Accounting Standards Board (GASB).

GASB establishes accounting rules for information in financial reports of public employers. Recent GASB Statements 43 and 45 require employers to record the costs of Other Post-Employment Benefits (OPEB). OPEB refers to retiree benefits other than pensions. This includes benefits such as medical, prescription drug, dental, vision, life insurance, disability, and long-term care.

The purpose of this issue paper is to brief the SCPP on the new accounting standard and discuss its implications for the state and local governments.

### **Staff**

Philip Martin McCaulay, FSA, EA, MAAA, Senior Pension Actuary (360) 786-6150

**Impact**

GASB 43 and 45 impact the financial statements of public employers (states, counties, and cities) who subsidize retiree medical premiums, including Washington state and its local governments, as well as the former employers of Law Enforcement Officers and Fire Fighters (LEOFF) Plan 1 retirees. The new accounting rules could impact the state's and municipality's bond ratings as well as the cost of borrowing. The GASB 45 expense for a typical plan would likely be about five to ten times the pay-as-you-go cost. Plans with higher ratios of liabilities for retirees compared to active members would cost less as a multiple of the pay-as-you-go cost.

**Current Situation**

Currently, GASB allows post-retirement medical benefits to be accounted for on a pay-as-you-go basis. The expense for accounting purposes is currently equal to the sum of the benefits paid.

Currently, post-retirement medical benefits are also funded on a pay-as-you-go basis. In other words, there is no pre-funding. Payments for medical benefits for LEOFF Plan 1 retirees are also funded under a pay-as-you-go method.

State, K-12, and higher education employees who are retired may continue participation in medical benefits at a subsidized rate through the Public Employees Benefits Board (PEBB). Premiums charged to those not yet eligible for Medicare are based on the experience of the community-rated risk-pool and are "implicitly subsidized." An implicit subsidy occurs when the rate charged is a blended rate that is less than the rate that would apply to the retirees by themselves.



Premiums charged to those eligible for Medicare are calculated based on experience from their own risk pool and are “explicitly subsidized.” An explicit subsidy exists when the employer pays a specific part of the cost. The total subsidy for the retirees in PEBB for the 2003-2005 biennium was estimated to be \$223 million for the state.

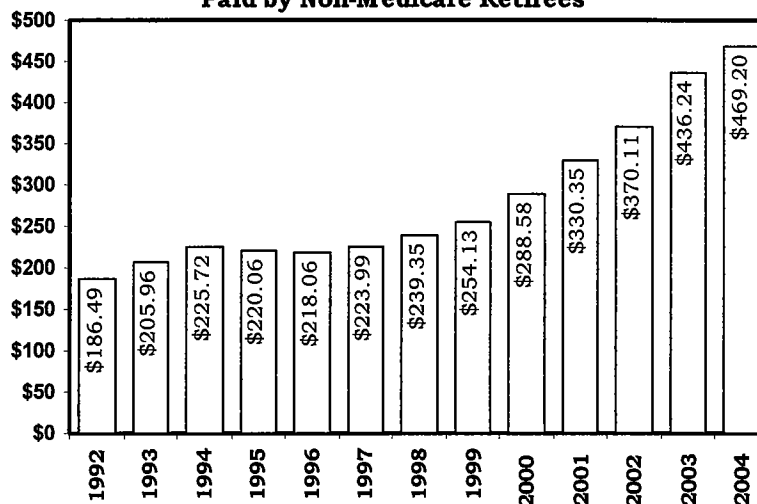
In absence of effective cost containment strategies, this subsidy may grow sharply in the near future. Short term medical inflation is expected to be around 10 to 15 percent. Long-term medical inflation is expected to be more in line with general inflation. The inflation on prescription drug costs is assumed to be higher than medical inflation.

County, municipal, and other political subdivision employees may or may not have retiree medical benefits, depending on the employer. Some counties and cities allow retirees to be covered by their own medical plans. The subsidies vary.

### **Retiree Premiums**

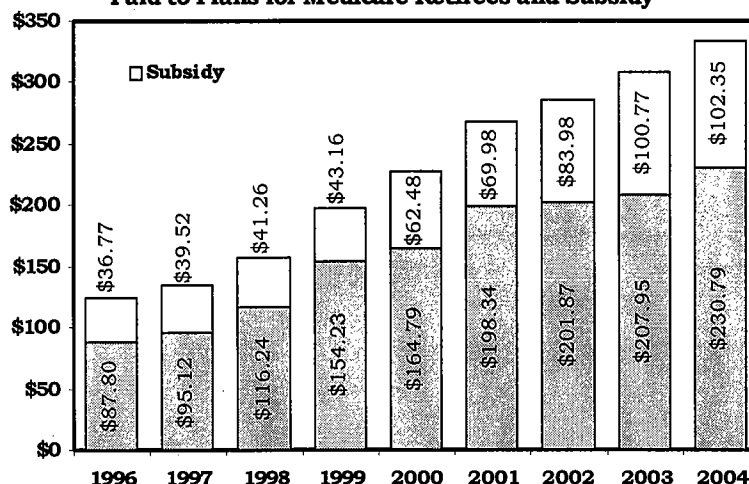
Retirees in PEBB may purchase health insurance by paying the same premiums as are paid by their employers. Information on PEBB premiums for 2006 is shown in Appendix A. The weighted average of the PEBB premiums paid by non-Medicare retirees from 1992 to 2004 is illustrated in Figure 1.

Figure 1  
Average Monthly PEBB Premium  
Paid by Non-Medicare Retirees



Retiree medical premiums are generally higher before age 65 because Medicare coverage starts at 65. The health insurance premiums for Medicare-eligible retirees (age 65 and over) in PEBB are less than the premiums for non-Medicare retirees (see Figure 2). The total premium includes the portion paid by the retirees plus the explicit subsidy.

Figure 2  
Average monthly PEBB Premium  
Paid to Plans for Medicare Retirees and Subsidy



### Comparison with Other States

Information on retiree medical benefits offered in other states is summarized in Appendix B.

### Explicit and Implicit Subsidies

There are two types of subsidies - explicit and implicit. The cost of both types of subsidies must be accounted for under GASB 45. With an explicit subsidy, the employer pays a specific part of the cost. With an implicit subsidy, the rate charged to retirees is a blended rate based on the rate charged to active members. The blended rate is less than the rate that would apply to the retirees only. The implicit subsidy is the difference between the age-adjusted premium and the blended premium. It is these subsidy amounts that need to be accounted for under these new rules. There is no distinction between an implicit and an explicit subsidy for accounting purposes. Appendix C of this paper has more information on the GASB 45 guidance on age-adjusted premiums, and how to use the tables from GASB 45 to calculate the subsidy.

### Explicit and Implicit Subsidies in PEBB in 2006

For Medicare retirees in PEBB, there is an explicit subsidy of \$131.87 per month (or 50 percent of the premium, whichever is less) for 2006. The pre-Medicare retirees in PEBB have a higher risk factor than actives which results in an age-adjusted premium of \$1,064 per month. The implicit subsidy for pre-Medicare is the difference between the age-adjusted premium of \$1,064 per month and the blended rate of \$689.71 per month. The implicit subsidy is about \$375 per month, or about 35 percent of the age-adjusted premium.

| Retiree             | Claims                     | Premium                    | Subsidy                    |
|---------------------|----------------------------|----------------------------|----------------------------|
| <b>Pre-Medicare</b> | \$1,064/mo. age-adjusted   | \$689/mo. blended premium  | \$375/mo. implicit subsidy |
| <b>Medicare</b>     | \$458/mo. experience rated | \$326/mo. experience rated | \$132/mo. explicit subsidy |

## **Accounting Issues**

GASB sets accounting rules for financial reports of public employers. The new GASB rules for retiree medical benefits are effective at the end of calendar year 2006. Public employers who follow generally accepted accounting principles (or GAAP) will be required to disclose retiree medical liability and expense in their financial statements.

GASB Statements 43 and 45 apply to OPEB. GASB 43 has guidance for disclosure of changes in assets of OPEB plans. GASB 45 has guidance for disclosure and expense of liabilities of OPEB plans.

### **GASB 45 Effective Dates**

The GASB 45 effective dates are based on the size of a public employer's annual revenue. The rules would be effective for the State of Washington for the first period beginning after December 15, 2006, or starting in the fiscal year ending in 2008.

| <b>Annual Revenues</b>       | <b>Financial Statements for periods beginning after:</b> |
|------------------------------|--|
| In excess of \$100 million   | 12/15/2006   |
| \$10 million - \$100 million | 12/15/2007   |
| Less than \$10 million       | 12/15/2008   |

### **Retiree Medical Valuations**

GASB 45 requires OPEB actuarial valuations at least biennially and tri-annually if the plan covers less than 200 members. Performing retiree medical valuations is similar to performing pension plan actuarial valuations. A description of the assumptions for the discount rate and the healthcare cost trend rate are shown below. Additional details on performing retiree medical valuations are shown in Appendix D.

### **Discount Rate**

GASB requires the employer to select a discount rate or interest rate that is linked to the expected return on assets. Like all assumptions used for GASB 45 reporting, the rate should be selected using guidance from the actuarial standards of practice. The rate depends on whether or not there is pre-funding. The GASB discount rate may be between 7 percent and 8 percent if

the benefits are pre-funded. It is likely to be between 2 percent and 5 percent if the funding method is pay-as-you-go. It is likely to be between 5 percent and 7 percent if partially funded. An increased GASB liability could have a negative impact on bond ratings.

### Healthcare Cost Trend Rate

Guidance from the actuarial standards of practice leads to the assumption that medical inflation is assumed to start high and come down. The guidance from the actuarial standards also leads to assumptions that the short term medical inflation is expected to be around 10 percent to 15 percent, long-term medical inflation is expected to be more in line with general inflation, and the inflation on prescription drug costs is assumed to be higher than medical inflation.

### Trend Rate Example

| Year | Medical | Rx    |
|------|---------|-------|
| 2005 | 13.5%   | 15.5% |
| 2007 | 11.5    | 13.5  |
| 2009 | 9.5     | 11.5  |
| 2011 | 7.5     | 9.5   |
| 2013 | 5.5     | 7.5   |
| 2015 | 3.5     | 5.5   |
| 2017 | 3.5     | 3.5   |

### GASB 45 Expense

The GASB 45 expense for a typical plan would likely be about five to ten times the pay-as-you-go cost. The total pay-as-you-go cost of the subsidy for the retirees in PEBB for the 2003-2005 biennium was estimated to be \$223 million. This amount is similar to what would be expected based on the amounts of the subsidies and the counts of pre-Medicare and Medicare retirees. Using the estimated five to ten times ratio, the GASB 45 expense for 2003-2005 would have been in the \$1 billion to \$2 billion range. Plans with higher ratios of liabilities for retirees compared to active members would cost less as a multiple of the pay-as-you-go cost. Details on the components of the GASB 45 expense calculations are shown in Appendix E.

### **Funding Policy**

Issues related to funding policy include the policy regarding whether or not to prefund the liability and, if the benefits are pre-funded, what funding vehicle and what investments are appropriate. OPEB Obligation Bonds are a possible funding vehicle.

#### **Pre-Funding**

Post-retirement benefits are currently funded on a pay-as-you-go basis. Pre-funding is not required under GASB 45, but it does offer some advantages over the pay-as-you-go method. Using the pay-as-you-go method, the contributions equal the payments for a year. With pre-funding, the contributions exceed the payments to build up a fund. Pre-funding can result in a lower long term cost as a result of investment earnings on the fund.

Under GASB 45, pre-funding the benefits allows for the use of a higher discount rate (or interest rate) when calculating the value of liabilities. The liabilities disclosed for pre-funded benefits would be lower than the liabilities for pay-as-you-go benefits.

#### **Funding Vehicles**

There are a variety of funding vehicles available for OPEB liabilities. These include 401(h) accounts and Section 501(c)(9) trusts (VEBAs). Neither a VEBA nor a 401(h) account would typically be sufficient to fund the liabilities on their own, but they could be used together. Section 420 Transfers allow surplus defined benefit plan assets to be transferred to a 401(h) account. Health Savings Accounts (HSAs) may be used with high-deductible plans.

#### **Section 401(h) Accounts**

Section 401(h) accounts are simple to establish. A 401(h) account is a separate account within a qualified pension plan for use in paying medical expenses for retirees, spouses, and dependents. Investments in 401(h) accounts accumulate tax-free and benefits are not taxable when received. Cumulative contributions to the 401(h) account may not exceed 25 percent of the total pension contributions.

### **Section 420 Transfer**

Under a Section 420 Transfer, a portion of surplus pension assets are transferred to a 401(h) account to be used to reimburse an employer for current year retiree medical liabilities. Only one transfer is permitted per year. Retiree medical benefits may not be reduced for five years following the transfer.

### **VEBA**

A VEBA would be a separate trust. VEBA assets are not subject to tax for tax-exempt organizations and benefits are not taxable when received.

### **Health Savings Accounts (HSAs)**

HSAs have tax-advantages, but only apply if the members are covered by a high-deductible plan. The accounts are self-directed. Distributions for purposes other than medical benefits are subject to income tax and a 10 percent excise tax.

### **OPEB Obligation Bonds**

GASB received questions about the issue of funding liabilities using OPEB Obligation Bonds. OPEB Obligation Bonds are described in Question 33 of the GASB 45 Implementation Guide. Similar to Pension Obligation Bonds, OPEB obligation bonds are unsecured debt that could be issued and the proceeds could be used to fund the unfunded OPEB liability. The liability would be shifted from an amount owed to current and future retirees to the capital markets. The advantages and disadvantages of this strategy are listed below.

#### *Advantages of OPEB Obligation Bonds:*

- Employers would be able to use a higher discount rate for GASB 45 disclosure.
- Benefits would be more secure.

### *Disadvantages of OPEB Obligation Bonds:*

- Reduction in flexibility for financing debt.
- Bonds would not be tax-exempt.
- Risky transaction to attempt to use arbitrage.
- No guarantee that the fund return will exceed the cost of the debt.

### **Impact on Bond Ratings**

GASB 45 will have an impact on the bond ratings of public employers. A deterioration of a bond rating would increase the cost of borrowing. Rating agencies including Standard & Poor's and Fitch Ratings will monitor GASB 45 liabilities. The rating agencies will determine if bond ratings for states and municipalities need to change as a result of GASB 45 disclosures.

The rating agencies have published reports that give insight into their positions on GASB 45. Standard & Poor's issued an April 15, 2003, report titled "Managing Other Post-employment Benefits (OPEB) Under the Proposed Reporting Changes" and a December 15, 2004, report on "Reporting & Credit Implications of GASB 45 Statement on Other Post-employment Benefits." Fitch Ratings published a June 22, 2005, report titled "The Not So Golden Years – Credit Implications of GASB 45."

Standard & Poor's stated that they will include GASB 45 information as part of their ongoing analytical surveillance of ratings. They will "weigh the effect these (OPEB) obligations may have on the employer's ability and willingness to pay debt service on their bonds." Standard & Poor's states that "cases may arise in which OPEB obligations, due to their relative magnitude, act to constrain employers' creditworthiness." Their report goes on to say that "very close attention will be paid to the newly quantified OPEB unfunded liabilities, given their expected magnitude, and to the employers' strategies for managing them."

The Fitch report states that the actuarial cost of GASB 45 liabilities could be five to ten times the pay-as-you-go cost. Fitch Ratings states "an absence of action taken to fund OPEB liabilities or otherwise manage them will be viewed as a negative rating factor;" and "as actuarial standards for OPEB become clear, Fitch will review the underlying assumptions and will view negatively any that are overly aggressive." The report goes on to say that "reality dictates that an entity may opt to defer OPEB funding in times of budget stress."



Regarding funding of benefit liabilities, the position of Fitch is that “indefinite deferrals are damaging to credit quality.” The report concludes: “While not debt, pension, and OPEB accumulated costs are legal or practical contractual commitments that form a portion of fixed costs.” And “long-term deferral of such obligations is a sign of fiscal stress that will be reflected in ratings.”

It is imperative that public employers take steps to address the issues related to GASB 45 in order to respond to inquiries from the bond rating agencies. This includes identifying the magnitude of the liabilities and developing strategies for managing the cost.

### **Future Health Care Strategies**

The bond rating agencies are interested in future health care strategies to hold back rising health-care costs. The Health Care Authority (HCA) has information on their web site available at <http://www.hca.wa.gov/index.shtml> that describes how HCA is looking at the cause of higher health-care costs, and opportunities for future savings. HCA is analyzing how to:

- Maintain a healthy workforce;
- Engage employees in becoming smarter health-care consumers, and changing behaviors;
- Better manage care for high-cost services and treatments;
- Purchase collectively with other large employers; and
- Seek higher quality standards from plans and providers.

### **Summary**

In summary, retiree medical premiums have an implicit and explicit subsidy and GASB 45 requires recognition of the present value of these subsidies effective with the fiscal year ending in 2008. Under the current pay-as-you-go funding policy, the expense will be significantly higher than with prefunding. An increased GASB liability could have a negative impact on bond ratings.

The next steps for the State, Counties, and Cities include:

- Quantify GASB 45 liability and have actuarial valuations done at least biennially (HCA / OFM);
- Determine funding policy (Legislature);
- Develop strategies for managing liabilities (Legislature / HCA); and,
- Discuss with bond rating agencies (Treasury / OFM / OSA / DRS).

## Appendix A

### Monthly PEBB Retiree Rates in 2006

The PEBB premiums for 2006 ranged from \$137 per month for a single subscriber who is already enrolled in Medicare parts A and B, to \$1,345 per month for a full family not yet eligible for Medicare (see PEBB pamphlet for premiums by specific plan).

| <b>Monthly PEBB Retiree Rates</b>                          |               |                |
|--|---------------|----------------|
| <i>Effective January 1, 2006</i>                           |               |                |
| <b>Medical Rates without Medicare</b>                      |               |                |
|  | <b>Lowest</b> | <b>Highest</b> |
| Subscriber Only  | \$369.51      | \$493.87       |
| Subscriber & Spouse  | \$731.38      | \$980.10       |
| Subscriber & Child(ren)                                    | \$640.91      | \$858.54       |
| Full Family  | \$1,002.78    | \$1,023.73     |
| <b>Medical Rates with both Parts A &amp; B of Medicare</b> |               |                |
| Subscriber Only  | \$137.41      | \$308.45       |
| Subscriber & Spouse (1 eligible)                           | \$542.30      | \$794.68       |
| Subscriber & Spouse (2 eligible)                           | \$267.18      | \$609.26       |
| Subscriber & Child(ren)                                    | \$441.08      | \$673.12       |
| Subscriber & Child(ren) (2 eligible)                       | \$267.18      | \$609.26       |
| Full Family (1 eligible)                                   | \$827.31      | \$1,159.35     |
| Full Family (2 eligible)                                   | \$570.85      | \$973.93       |
| Full Family (3 eligible)                                   | \$396.95      | \$910.07       |
| <b>Dental Plans with Medical Plan</b>                      |               |                |
| Subscriber Only  | \$33.36       | \$43.46        |
| Subscriber & Spouse  | \$66.72       | \$86.92        |
| Subscriber & Child(ren)                                    | \$66.72       | \$86.92        |
| Full Family  | \$100.08      | \$110.82       |

## Appendix B

### Retiree Health Benefits Comparisons with Other States

Allowing retirees to pay subsidized premiums to continue their health coverage is a common benefit strategy employed by other states as illustrated in the following chart. Of the systems examined, CalPERS, CalSTRS, Colorado, and Ohio provided for retiree health insurance through the retirement plans. Other comparable states' retirement systems may or may not administer the retiree health insurance, but it's the retirees who pay the bulk of the premiums.

All 50 states make health insurance available to retirees up to the age of 65 and 48 states provide coverage under the state plan for retirees age 65 or older. In 11 states, the state pays the full cost of individual coverage for retirees under age 65, who are not yet eligible for Medicare. Seventeen states pay the full premium for Medicare-eligible retirees over the age of 65. Several states reported that the retiree's share of health care premiums depends upon the date hired, date of retirement or years of service at retirement.\*

\* 2004 State Employee Benefits Survey, *Workplace Economics*.

## Retiree Health Care Provisions by Select Retirement Plan

| System                   | Pre-Medicare Eligible  | Medicare Eligible  |
|--------------------------|--|--|
| <b>Cal PERS</b>          | Recent members need 20 yrs. service to receive 100% of state retiree medical contribution.   | Member are eligible for supplemental benefits.   |
| <b>Cal STRS</b>          | Depends on bargaining agreement -- may be as much as full medical coverage depending on School District.                               | Members receive regular Medicare coverage.   |
| <b>Colorado PERA</b>     | Members and dependents are eligible for PERA Care: Subsidized medical, dental, and vision plans.                                       | Members enrolled in Medicare part B are also eligible for PERA Care.                             |
| <b>Florida (FRS)</b>     | Members may continue in employer provided group insurance plan and receive a subsidy of \$5 per year of service to a maximum of \$150. | Members continue to receive the \$5 per year of service subsidy to a maximum of \$150 per month. |
| <b>Idaho (PERSI)</b>     | Members are allowed to continue coverage in the group medical plan.  | Members may purchase supplemental depending on employer.   |
| <b>Iowa (IPERS)</b>      | Members are allowed to continue with insurance group.  | Members need to have both Parts A and B of Medicare and state becomes secondary payer.           |
| <b>Minnesota (MSRS)</b>  | Members are allowed to continue with insurance group (may pay into Health Care Savings Plan when employed).                            | Members are eligible for a Medigap policy.   |
| <b>Missouri (MOSERS)</b> | Members and family are eligible to participate in any employer provided group insurance plans.   | Members and family are eligible to participate in any employer provided group insurance plans.   |
| <b>Ohio (OPERS)</b>      | Majority of health premiums paid by OPERS. Remaining premiums deducted from the recipient's monthly benefit check.                     | Medicare part B reimbursed. Ohio plans become secondary payers.                                  |
| <b>Oregon PERS</b>       | Members may purchase group health and dental insurance.  | Retiree may purchase Medicare companion insurance, state provides \$60/month subsidy.            |
| <b>Seattle (SCERS)</b>   | Members may continue coverage at group rates.  | Medicare supplemental insurance available.   |

## Appendix C

### Blended Premiums and Age-Weighted Premiums

Retirees in PEBB pay a blended premium rather than an age weighted premium. GASB 45 requires disclosure based on the age-weighted premium. The following example from Question 58 of the GASB 45 Implementation Guide shows a plan that covers both active members and retirees. The plan has total premiums of \$1.440 million, retiree contributions of \$0.288 million, and employer contributions of \$1.152 million.

Using a blended premium, the premiums for the retirees in the example from the Implementation Guide equal the retiree contributions of \$0.288 million, and the premiums for the active members are \$1.152 million. Using age-weighted premiums, the premiums for retirees are \$0.481 million and the premiums for actives are \$0.959 million. There has been a shift of \$0.193 million from the active member premiums and employer contributions to the retirees, and the \$0.288 million contribution from the retirees remained the same. In the following example taken from the Implementation Guide, the rate for the retirees is being subsidized by the rate for the actives. This is called an implicit subsidy.

#### Example of Blended Premium from GASB 45 Implementation Guide

| Annual Amounts in Millions | Active Members | Retirees in Active Plan | Total   |
|----------------------------|----------------|-------------------------|---------|
| Total Blended Premiums     | \$1.152        | \$0.288                 | \$1.440 |
| Less Member Contributions  | \$0.000        | \$0.288                 | \$0.288 |
| Employer Contributions     | \$1.152        | \$0.000                 | \$1.152 |

#### Example of Age-Weighted Premium from GASB 45 Implementation Guide

| Annual Amounts in Billions | Active Members | Retirees in Active Plan | Total   |
|----------------------------|----------------|-------------------------|---------|
| Total Blended Premiums     | \$0.959        | \$0.481                 | \$1.440 |
| Less Member Contributions  | \$0.000        | \$0.288                 | \$0.288 |
| Employer Contributions     | \$0.959        | \$0.193                 | \$1.152 |

### **Age-Adjusted Premium Factor**

GASB 45 has default factors for calculating the age-adjusted premium. It requires calculating the average age of all actives and retirees in plan with a blended rate, then calculating the mid-point between the expected retirement age and age 65. There is a table for looking up the age-adjusted premium factor based on the average age and the midpoint age.

As an example of an age-adjusted premium factor, suppose a plan has an average age of 47 for all actives and retirees in a plan with a blended rate. The average expected retirement age is age 59.

The mid-point between the expected retirement age and age 65 is age 62. From the table, there is a factor of 1.8 based on an average age of 47 and a midpoint age of 62. Then the retiree premium would be 1.8 times the blended premium.

To use the GASB 45 table of age-adjusted premium factors in an example, suppose that the blended premium for actives and non-Medicare retirees is \$690 per month. The age-adjusted premium for retirees is 1.8 times the blended premium. The age-adjusted premium is \$1,242 per month. Using the GASB 45 table of age-adjusted premium factors, the implicit subsidy is \$1,242 minus \$690, or \$552 per month.

## **Appendix D**

### **Retiree Medical Valuations**

Performing retiree medical valuations is similar to performing pension plan actuarial valuations. It requires gathering information on the benefit provisions and member data, setting assumptions and methods, determining the funding and contribution policy, and calculating the accounting expense.

Regarding the benefit provisions, information is needed about the eligibility requirements and the types of coverage offered, for example, medical, prescription drugs, dental, and long-term care. Information is needed on employer paid premiums, retiree contributions, and family coverage.

For the member data, the pension data could be used as a starting point. Data is needed on the type of coverage, such as individual, family, or not enrolled; and the types of plans, such as medical, dental or both.

### **Methods and Assumptions**

Actuarial valuations for OPEB require a set of methods and assumptions similar to those used for pension valuations, plus additional medical plan related assumptions:

- Discount rate.
- Medical inflation rate.
- Age-based claim costs or premiums.
- Retiree contributions.
- Utilization rate and Medicare coverage.
- Decrements (retirement, withdrawal, mortality, disability).

### **Actuarial Cost Method**

GASB 45 allows employers to choose from six actuarial cost methods for determining OPEB liabilities:

- Projected Unit Credit (PUC).
- Aggregate.
- Entry Age Normal (EAN).
- Frozen Entry Age.
- Attained Age.
- Frozen Attained Age.

### **Amortization Method**

GASB 45 has guidance on the method to use for amortizing the Unfunded Actuarial Accrued Liability (UAAL).

- Maximum 30-year amortization period for total UAAL.
- UAAL may be amortized in total or in components.
- May use level dollar method or level percentage of projected payroll.
- May include payroll growth rate but not membership growth rate.

### **Example of Method**

An example of a cost method and amortization method would be to use the Projected Unit Credit (PUC) cost method with a 30-year amortization of total UAAL, based on a level percentage of payroll and a payroll growth rate of 4.5 percent.



## Appendix E

### GASB 45 Expense Calculations

Three components of GASB 45 expense include:

1. Annual Required Contribution (ARC).
2. Annual OPEB Cost (Expense).
3. Net OPEB Obligation (NOO).

The ARC equals the normal cost plus the amortization. The normal cost is the value of the benefits earned in one year. The amortization is the cost of the payment on the UAAL.

#### Sample ARC Calculation

| Annual Amounts in Billions | 8% Discount Rate | 3% Discount Rate |
|----------------------------|------------------|------------------|
| Normal Cost                | \$0.2            | \$0.4            |
| Amortization               | \$0.3            | \$0.4            |
| ARC                        | \$0.5            | \$0.8            |

#### Net OPEB Obligation (NOO)

Initially the NOO is set to zero. A sole employer may elect to calculate the NOO retroactively. To get the end-of-year NOO, add the OPEB expense minus the amount actually contributed. The NOO is the cumulative difference between the OPEB expense and contributions. The annual OPEB Cost equals the ARC plus interest on the NOO minus the amortization of the NOO. Annual OPEB cost is equal to the ARC the first year when the NOO is set to zero.

**Sample NOO and Annual OPEB Cost**

| <b>Annual Amounts in Billions</b> | <b>8% Discount Rate</b> | <b>3% Discount Rate</b> |
|-----------------------------------|-------------------------|-------------------------|
| NOO 7/1/2007                      | \$0.0                   | \$0.0                   |
| ARC 2007-2008                     | \$0.5                   | \$0.8                   |
| Interest on NOO                   | \$0.0                   | \$0.0                   |
| Amortization of NOO               | \$0.0                   | \$0.0                   |
| Annual OPEB Cost                  | \$0.5                   | \$0.8                   |
| Contributions 2007-08             | \$0.1                   | \$0.1                   |
| Increase in NOO                   | \$0.4                   | \$0.7                   |
| NOO 6/30/2008                     | \$0.4                   | \$0.7                   |



## Medicare Part D

Select Committee on Pension Policy  
October 18, 2005

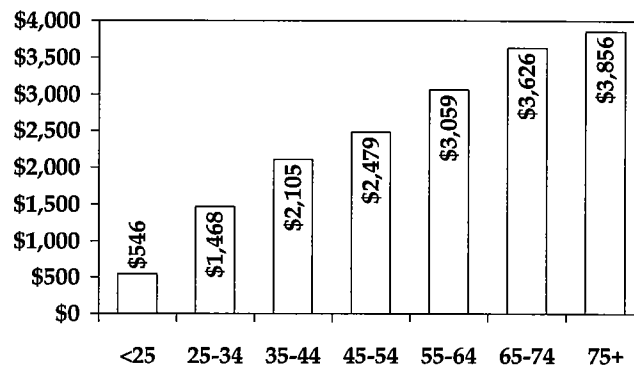


Robert Wm. Baker  
Senior Research Analyst

### Medical Insurance Coverage: A Growing Retirement Issue

- ❖ Overlap of issues of interest to standing Health Care Committees and SCPP.
- ❖ Medical expenses constitute a growing share of retirees' income.
- ❖ Adequacy of retirement benefits a concern.

## Annual Healthcare Expenditures by Age

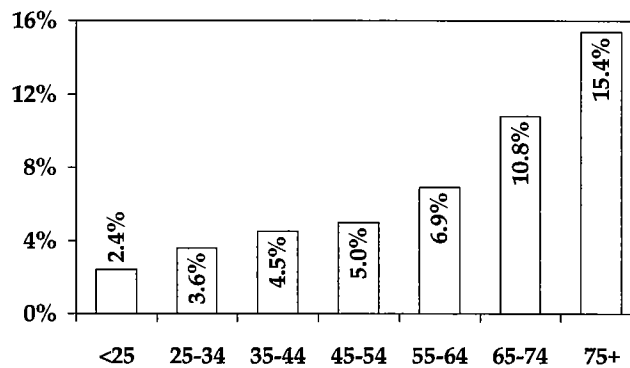


Source: BLS Consumer Expenditure Survey, 2003

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## Healthcare as a Percent of Total Expenditures by Age

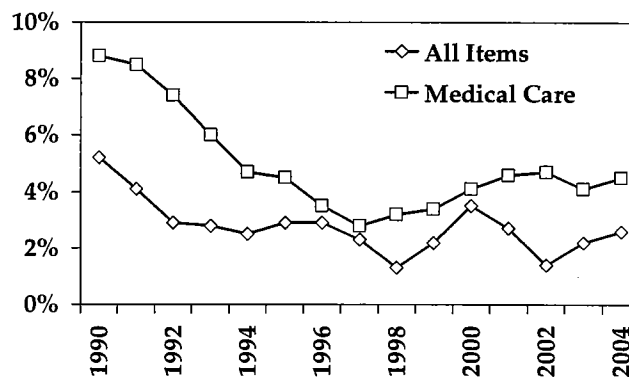


Source: BLS Consumer Expenditure Survey, 2003

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## Annual Change in CPI-W All Items and Medical Care: 1990-2004



Source: Bureau of Labor Statistics

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## Medicare and Drugs

- ❖ Since 1965 no prescription drug coverage.
- ❖ Drug cost accelerating fastest of all medical costs.
- ❖ Diminished adequacy.
- ❖ Less "if" more "when."
- ❖ Medicare Modernization Act of 2004:
  - Initial costs understated.
  - Trust Fund for Part A exhausted by 2019.

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## Medicare Part D

Beginning January 1, 2006, Medicare will offer prescription drug coverage to all those enrolled in Medicare Parts A and B as their primary health insurance coverage. This benefit is called Medicare Part D.

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## Medicare Basics

Medicare provides health coverage to people 65 and over. Those still employed with health coverage can delay Medicare Part B enrollment or use Medicare as secondary to the employer plan. For those not employed, Medicare is the primary payer.

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## Medicare Part A

- Medicare Part A includes coverage of:

- Inpatient hospital;
- Skilled nursing;
- Home health care;
- Hospice; and,
- Blood.

- No enrollee premium if member paid Medicare taxes while working.

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## Medicare Part B

- Includes coverage of:

- Outpatient;
- Professional;
- Limited preventive care; and,
- Some injectable and physician-administered drugs.

- 2005 monthly enrollee premium is \$78.20.

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## Medicare Part C

- ❖ Risk product:
  - Integrated Parts A and B;
  - Contracts with private risk-bearing health plans.
- ❖ Members must enroll in both parts.
- ❖ Premiums paid directly to Center for Medicare Services (CMS).

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## Medicare Part D

- ❖ Enrollees responsible for \$3,600 out-of-pocket costs.
- ❖ Third-party payers delay onset of catastrophic coverage.
- ❖ 2006 monthly enrollee premium is \$35.

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## Medicare Part D

| Coverage Ranges       | From    | To      | % Covered |
|-----------------------|---------|---------|-----------|
| Annual Deductible     | \$0     | \$250   | 0%        |
| Basic Benefit         | \$250   | \$2,250 | 75%       |
| Coverage Gap          | \$2,250 | \$5,100 | 0%        |
| Catastrophic Coverage | \$5,100 | no max  | 95%       |

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## Employer Options

- ❑ Maintain benefits equivalent to Medicare Part D:
  - ❑ Receive tax-free subsidy.
- ❑ Purchase or maintain separate drug coverage for retirees.
- ❑ Contract with CMS to become Part D plan sponsors.
- ❑ Make arrangements with MA-PDs or PDPs to purchase "off-the-shelf" or customized drug benefits for retirees.

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## Equivalent Benefits

- Actuarially comparable (creditable).
- Annual attestation.
- The gross and net values of retiree prescription drug coverage is at least equal to the actuarial gross and net values of coverage under Medicare Part D.

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## Plans Providing Equivalent Benefits

- Public Employees' Benefits Board
- Washington Counties Insurance Fund
  - Counties and other political subdivisions.
- Employee Benefits Trust:
  - Cities and Towns.

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## PEBB Access for Local Governments

Local governments may provide health care coverage for their active and retired employees through PEBB if the legislative authority determines, subject to collective bargaining, a transfer to the State HCA should be made.

RCW 41.04.205

## Retiree Health Insurance Access

A county, municipality, or other political subdivision that provides a health plan for its employees shall permit retired and disabled employees and their dependents to continue participation in a plan subject to the exceptions, limitations, and conditions set forth in this section.

RCW 41.04.208

## Medicare Part D Implications

For employers who provide “creditable” prescription drug coverage, Medicare Part D will be more of an administrative and subsidy recovery issue than a benefit/compliance issue.

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## Medicare Part D Implications

All employers, including local governments, who offer their retirees prescription drug coverage that is not “creditable” will need to choose from among the Employer Options so their retired employees can benefit from Medicare Part D.

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## Medicare Part D Implications

- ❖ Retirees without pharmacy coverage through their former employer will need to enroll during the open enrollment period from November 15, 2005, through May 15, 2006.

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## Policy Analysis

Retirement policy and healthcare policy are becoming more and more intertwined. As health care costs escalate, the ability of employers to provide consistent health benefits to retirees is diminished, and the adequacy of retirement benefits overall is diminished as retirees pay a greater share of their benefit for healthcare.

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## Policy Analysis

The current State retirement policy related to health care is to provide insurance access and implicit subsidies for retirees who are not Medicare eligible, and explicit subsidies to retirees who are Medicare eligible.

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## Policy Analysis

Federal subsidies related to Medicare Part D may provide State and local governments some financial support of benefits for Medicare-eligible public retirees, and require some fine-tuning of retiree health insurance funding provisions.

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## Highlights

- ❖ Healthcare is a growing retirement issue.
- ❖ Healthcare inflation detrimental to retirement benefit adequacy.
- ❖ Recent legislation has attempted to provide greater healthcare access.
- ❖ Numerous local governments will opt for the Medicare Part D Federal subsidy.
- ❖ Those not offering benefits will need to choose an “employer option” in order to help provide Medicare Part D coverage.

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# Select Committee on Pension Policy

## Medicare Part D

(October 7, 2005)

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### Issue

The Senate Health Care Committee and the House of Representatives Health and Long-Term Care Committee are currently the first points of contact for health care policy issues and legislation. Recently, however, health care has increasingly become a retirement-related issue. The cost of health care has escalated much more quickly than overall inflation and is absorbing ever increasing shares of retirees' income, particularly those who retire before Medicare eligibility. This has led to growing concern about the adequacy of retirement benefits. As a result, there is a burgeoning overlap in issues of interest to the standing health care committees and the Select Committee on Pension Policy (SCPP). The intent of this report is to keep the SCPP members up-to-date on important retiree medical coverage issues.

Through its numerous programs and parts Medicare is designed to provide health coverage to those of retirement age – age 65 and older. Beginning January 1, 2006, Medicare will offer prescription drug coverage to all people who are enrolled in Medicare Parts A and B as their primary health insurance coverage. This benefit is called Medicare Part D.

### Staff

Robert Wm. Baker, Senior Research Analyst  
(360) 786-6144

### Members Impacted

All retirees not eligible for health care benefits through the Public Employee Benefits Board (PEBB), or through their former employer, may be impacted by changes in benefits related to Medicare Part D.

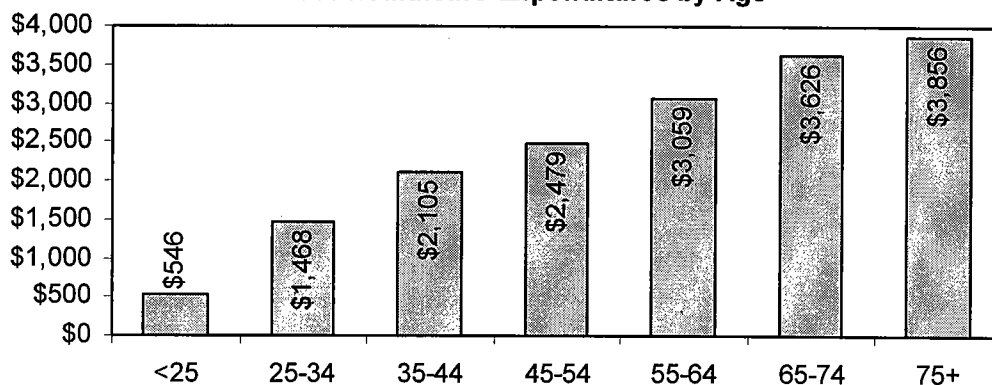


## Healthcare Cost Trends

Healthcare is a retirement issue due to the nature of aging and the needs of the aged. As people grow older, their healthcare needs increase; illnesses that may be considered incidental for young adults become urgent for senior citizens (influenza for example). The age dynamics of healthcare are such that the majority of an individual's lifetime healthcare expenses occur in the last two years of life.

On average, healthcare spending increases as people age. Based on the 2003 Consumer Expenditure Survey from the U.S. Department of Labor, the annual healthcare expenses of an individual 75 years of age are seven times that of an individual under 25 (see Figure 1).

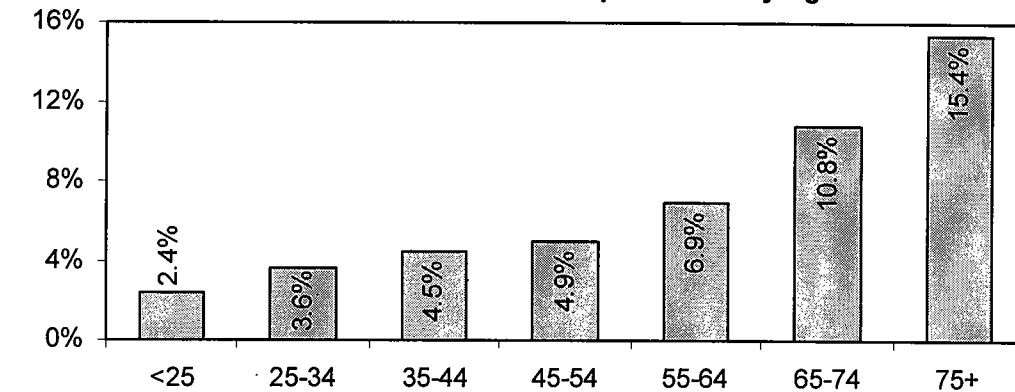
**Figure 1**  
**Annual Healthcare Expenditures by Age**



Source: BLS Consumer Expenditure Survey, 2003

Perhaps more revealing is the share of an individual's total annual expenditures absorbed by healthcare. While these expenses are increasing with age, income is not; those age 65 and older are likely to be on the down-slope of their earnings capabilities and more likely retired. With expenses rising while income is stagnant or falling, the share of income captured by healthcare can erupt. Again, based on the 2003 Consumer Expenditure Survey, healthcare expenses for those age 75 and older can draw over 15 percent of their total annual expenditures (see Figure 2); this is over three times the amount expended by someone in their peak-earnings years (age 45-54).

**Figure 2**  
**Healthcare as a % of Total Expenditures by Age**

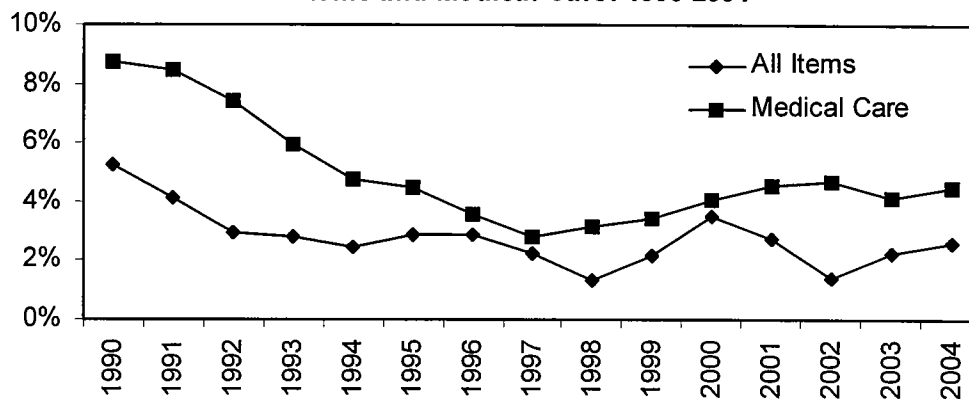


Source: BLS Consumer Expenditure Survey, 2003

## Medical Inflation

Medical care inflation has further complicated the matter. In the last two decades, the cost of medical care has increased at almost twice the pace of overall consumer prices (see Figure 3). This has a dramatic impact on retirees and elderly, particularly those on fixed incomes. In such an environment medical care will constitute an ever-increasing share of income, leaving less and less for other basic needs. Even those retirees with benefits indexed to an average cost-of-living measure can be negatively impacted in this environment; though not as immediate as those on a fixed income, the diminishment in value and adequacy of that retirement income will be pervasive.

**Figure 3**  
**Annual % Change in U.S. City Average CPI-W**  
**All Items and Medical Care: 1990-2004**



Source: Bureau of Labor Statistics

### **Current Situation**

Currently, medical benefits for State, K-12, and Higher Education retirees are administered by the PEBB, through the Washington State Health Care Authority (HCA).

Retiree health benefits provided by PEBB/HCA are principally the continuance of employer provided health benefits for those who are not, at the time of retirement, Medicare eligible. Retired members under age 65 are included in the active member "pool" and may continue their health care coverage by purchasing that coverage at active member costs.

When retired members are Medicare eligible – at age 65 – they enroll in Medicare and their PEBB/HCA coverage, or other employer coverage, become secondary to Medicare's primary coverage.

PEBB/HCA retiree health care benefits currently include prescription drug coverage that is considered to be "creditable coverage," meaning it is "at least as good" as Medicare Part D. As a result, prescription drug coverage for retired public employees is primarily an issue for those not eligible for PEBB/HCA benefits, or whose retiree medical plan does not include prescription drug benefits that are comparable to Medicare Part D, or those who have no retiree medical coverage.

### **Medicare and Drugs**

Since its inception in 1965, Medicare had not covered the cost of prescription drugs. Until the recent upsurge in medical inflation, this gap in coverage was more an inconvenience than a hardship. But in this current inflationary environment, many Medicare enrollees faced paying out-of-pocket for the one component of medical care whose costs were accelerating the quickest. As the adequacy of Medicare enrollees' benefits was being diminished, coverage for prescription drugs was becoming less of an "if" and more of a "when" issue.

The passage of the Medicare Modernization Act (MMA) of 2004 resulted in distinct prescription drug coverage. As with the original legislation in 1965, the cost of these benefits was understated. But because Part D is funded outside the Medicare Trust Fund which covers Part A, it will not have a direct impact on the current solvency issues surrounding Medicare (based on the most recent Trustees Report, the Trust Fund is expected to be exhausted by 2019).

### **Medicare Basics**

Medicare provides health coverage to people age 65 and over and some people with disabilities or end-stage renal disease. In general, members enroll for Medicare benefits at age 65. If an individual is still employed, with health coverage, the individual can delay Medicare Part B enrollment or use Medicare as secondary to the employer plan. If the individual is not employed, Medicare Part A is automatic. Until January 1, 2006, when Medicare Part D begins, Medicare has three Parts: A, B, and C.

#### *Part A- Hospital/Facility*

Medicare Part A includes coverage of inpatient hospital, skilled nursing, home health care, hospice, and blood. There is generally no enrollee premium if a person paid Medicare taxes while working. Enrollee cost sharing is a deductible of \$912 per inpatient stay/benefit period (up to 60 days); after 60 days there is a per-day cost-sharing amount. Skilled nursing facilities are also covered with a copay on stays between 21 and 100 days.

#### *Part B- Outpatient*

Medicare Part B includes coverage of outpatient, professional, limited preventive care, and some injectable and physician-administered drugs. The 2005 enrollee monthly premium is \$78.20. For 2004, Part B has an annual deductible of \$110, and 20 percent coinsurance (50 percent for outpatient mental health). There is no out of pocket maximum. MMA made changes that index the Part B deductible to inflation. The Part B deductible will be updated annually by the same percentage as the Part B premium. Part B premium subsidies are linked to income. MMA also adds preventive benefits to Part B in 2005, including: initial routine physical exam, cardiovascular blood screening tests, and diabetes screening tests and services.

#### *Part C- Medicare Advantage*

Medicare Advantage (formerly Medicare + Choice) is Medicare's risk product, offering integrated Part A and B benefits through contracts with private risk bearing health plans. Members must enroll in both Parts A and B, and pay premiums directly to CMS.

### **Medicare Part D Design**

The standard Part D prescription drug benefit has a \$250 deductible (see Figure 4). After the retiree has spent \$250 out-of-pocket on prescription drugs, Medicare will pay 75 percent of the next \$2,000 in prescription drug costs up

to \$2,250. After that the retiree will pay all the prescription drug costs up to a total of \$5,100. As a result, the member will have paid a total of \$3,600 out-of-pocket of the first \$5,100 in prescription drug purchases; this is called the True-Out-of-Pocket (TrOOP) cost. Additional prescription drug needs will be considered catastrophic and the retiree will pay only 5 percent of subsequent covered charges with Medicare paying for the remaining 95 percent.

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**Figure 4**  
**Standard Medicare Part D Benefit**

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| Coverage Ranges       | From    | To                   | % Covered |
|-----------------------|---------|----------------------|-----------|
| Annual deductible     | \$0     | \$250                | 0%        |
| Basic benefit         | \$250   | \$2,250              | 75%       |
| Coverage gap          | \$2,250 | \$5,100 <sup>1</sup> | 0%        |
| Catastrophic coverage | \$5,100 | No max               | 95%       |

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<sup>1</sup> Assumes no third-party payments

Medicare Part D enrollees are responsible for a total of \$3,600 in out-of-pocket costs. If they have a third-party insurer, no amounts paid by the insurer counts toward the \$3,600 out-of-pocket requirement. Third party payments will effectively delay the start of Medicare Part D catastrophic coverage. If, for example, a supplemental insurer chooses to offer coverage to fill the gap with a plan paying 75 percent of those costs, then the member's catastrophic coverage would begin after \$13,650 in total drug spending. In all cases the beneficiary is going to pay a total of \$3,600 prior to the start of Medicare Part D catastrophic coverage.

The estimated enrollee premium for Part D in 2006 will be \$35 per member per month. This amount will increase each year. Premiums may be higher (premium penalty) for late enrollees who go without creditable pharmacy coverage.

### **Employer Options**

Medicare regulations had several options for both public and private employers who offer retirees prescription drug coverage under any health plan. Employers could:

- Maintain a benefit plan that is actuarially equivalent to Medicare Part D and receive a tax-free subsidy;

- Purchase or maintain separate prescription drug coverage for retirees that supplements or “wraps around” Medicare Part D;
- Contract with the Center for Medicare and Medicaid Services (CMS) to become Part D plan sponsors themselves; or,
- Make arrangements with Medicare Advantage Prescription Drug plans (MA-PDs) or Prescription Drug Plans (PDPs) to purchase “off-the-shelf” or customized drug benefits for their retirees.

Employers choosing the first option to maintain a benefit plan that is actuarially equivalent to Medicare Part D must submit an actuarial attestation to CMS annually, even if the employer provided coverage has not changed. The actuary must attest that the actuarial gross and net values of the employer's retiree prescription drug coverage for the plan year is at least equal to the actuarial gross and net values of standard coverage under Medicare Part D.

The HCA chose the first option to maintain the actuarially equivalent retiree drug plan and receive the subsidy. This required legislation. In the most recent legislative session, HB 1287 was signed into law as Chapter 195, Laws of 2005. The legislation authorized the HCA to participate in Medicare Part D and to receive the federal subsidy for continuing to provide retirees health coverage that includes a pharmacy benefit.

### **PEBB Coverage**

The above description of Medicare Part D is the plan in its basic design. There are numerous ways public employers who are offering pharmacy benefits to their retirees can be in compliance. At this point in time, each of the health care plans offered through PEBB offer prescription drug benefits. Figure 5 provides a comparison between the Uniform Medical Plan (UMP), the Preferred Provider Organization (PPO), UMP Neighborhood, and the managed care plans. The principal difference between the plans is the use of cost caps in the UMP and use of co-pays in the managed care plans.

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**Figure 5**  
**Prescription Drug Benefits Through PEBB Sponsored Plans**

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**UMP PPO,  
UMP Neighborhood**

For prescriptions filled at a retail pharmacy, up to 90 days supply of:

- Tier 1 (generic) prescriptions; plan payment of 90 percent.

For prescriptions filled at network retail pharmacies, up to 30-day supply of:

- Tier 1 (generic) and Tier 2 (preferred brand-name); enrollee cost-sharing cap of \$75.

For prescriptions filled through mail order, up to a 90-day supply of:

- Tier 3 (nonpreferred brand-name); enrollee copayment of \$100.

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**Managed Care Plans**

Community Health Plan of Washington; Group Health Cooperative; Group Health Options, Inc.; Kaiser Foundation Health Plan of the Northwest; PacifiCare of Washington, Inc.; Regence BlueShield.

For prescriptions filled at a retail pharmacy, up to a month's supply of:

- Formulary generic, all insulin, and all disposable diabetic supplies, \$10 copay;
- Formulary brand-name, \$25 copay;
- Non-formulary, \$40 copay.

For prescriptions filled through mail order, up to 90-day supply of:

- Formulary generic, all insulin, and all disposable diabetic supplies, \$20 copay;
- Formulary brand-name, \$50 copay;
- Non-formulary, \$80 copay.

Exceptions: Group Health Cooperative and Group Health Options have only \$10 and \$30 copays for retail and \$20 and \$40 copays for mail order. Kaiser Permanente has only \$10 and \$25 copays for retail and \$20 and \$50 copays for mail order.

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## **Local Government Retiree Health Benefits**

Local governments – counties, municipalities, or other political subdivisions of the state – may provide health care coverage for their active and retired employees through PEBB if the legislative authority of the local government determines, subject to collective bargaining under applicable statutes, a transfer to an insurance or self-insurance program administered by the State HCA should be made; this is allowed under RCW 41.04.205 (see Appendix A). There are currently 228 political subdivisions providing their employees benefits through PEBB. Those local governments who opt not to make that determination administer their health care plans independent of PEBB and HCA.

## **Local Government Obligations**

Local governments who provide health benefits to their employees are, with certain significant exceptions, required to offer their retirees similar benefits under RCW 41.04.208(2) as found in the general provisions of the Washington State Public Employment, Civil Service, and Pensions statutes (see Appendix B). This resulted from the passage ESSB 5777 during the 2002 legislative session (Chapter 319, Laws of 2002). Local governments were required to enact these benefits by January 1, 2004. Amendments in 2004 removed those coverage requirements for local government employers who had made a "documented good faith effort" to provide such coverage but were unsuccessful.

If the health care benefits offered to active and retired local government employees include prescription drug coverage (pharmacy benefits) that is actuarially comparable i.e., "creditable" coverage, Medicare Part D will be more of an administrative and subsidy recovery issue than a benefit/compliance issue. For instance, those counties and other political subdivisions who provide active and retired employees health coverage through the Washington Counties Insurance Fund (WCIF) have more generous prescription drug coverage than that offered through Medicare Part D and their members probably need not be enrolled. Similarly, the 14,000 employees and retirees who receive health insurance through the Employee Benefits Trust (EBT) administered by the Association of Washington Cities will likely find it unnecessary to enroll in Medicare Part D.

For those local government employers who offer their retirees prescription drug coverage that is not "creditable," they will need to make choices, as outlined in the earlier "Employer Options" section, in order that their retired employees can benefit from Medicare Part D.

Retirees who do not have pharmacy coverage through their former employer will need to enroll during the open enrollment period between November 15, 2005, and May 15, 2006. Medicare will notify retirees of plans available in their areas.

## **Policy Analysis**

Retirement policy and healthcare policy are becoming more and more intertwined. As health care costs escalate, the ability of employers to provide consistent health benefits to retirees is diminished, and the adequacy of retirement benefits overall is diminished as retirees pay a greater share of their benefit for healthcare.



The current state retirement policy related to healthcare is to provide insurance access and implicit subsidies for retirees who are not medicare eligible (the difference between active member premiums and what retirees would otherwise pay) and explicit subsidies to retirees who are medicare eligible (specific dollar-per-member contributions). The availability of Federal subsidies related to Medicare Part D may provide state and local governments additional financial support of benefits for Medicare-eligible public retirees. For current state policy, this does not appear to warrant anything more than a fine-tuning of retiree health insurance funding provisions as accomplished in recent legislation.

### **Highlights**

- Access to health insurance and healthcare expenditures are a growing retirement issue.
- Above average healthcare inflation is detrimental to retirement benefit adequacy.
- Recent legislation regarding local government retiree health care access has attempted to provide health insurance access policies similar to those of the state.
- It is likely that numerous local governments in Washington State have made similar decisions to those of the HCA in regards to Medicare Part D.
- Political subdivisions that offer retiree health insurance access and pharmacy benefits that are not “creditable,” will need to choose from among the specific employer options in order to help provide Medicare Part D coverage.

## **Appendix A**

### **Health Care Authority Analysis on Medicare Part D**

#### **BACKGROUND:**

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (MMA) was signed into law December 8, 2003. The MMA is the largest reform of Medicare since its inception in 1965. The highest profile provision of the MMA was the creation of Part D, an optional pharmacy benefit that will become available beginning January 2006.

In recognition that many Medicare beneficiaries have retiree health coverage through an employer, the MMA and the proposed regulations outline several options for employers to respond to Part D. The design of Part D and the options for employers are generally calculated to provide incentives for employers to continue to offer a pharmacy benefit.

The Centers for Medicare and Medicaid Services (CMS) released proposed regulations in August 2004 that are intended to provide guidance on Part D for a variety of audiences, including employers. The proposed regulations are insufficient to make a final recommendation for PEBB and HCA as they do not offer a recommended direction, but rather ask for comment on a variety of options, each of which has different implications for HCA/PEBB. This document will conclude with a preliminary recommendation for use in developing assumptions for a project management plan for 2005, leading to implementation in 2006. Any plan will require contingency planning in the event that assumptions about the final regulations are incorrect. Final regulations from CMS are expected in the first quarter of 2005 at which point there may or may not be reason to revisit HCA/PEBB's decision regarding coordination with Part D.

In order to lay out the employer options, this background section begins with basic information on Medicare as it exists today, PEBB Medicare retirees' options as they exist today, and the new Part D benefit that becomes available January 1, 2006.

#### **Medicare Basics**

Medicare provides health coverage to people age 65 and over, and some people with disabilities or end stage renal disease. If an individual is still employed with health coverage, the individual can delay Medicare Part B enrollment or use Medicare as secondary to the employer plan. If the individual is not employed, Medicare is the primary payer. Medicare Part A is automatic.

Until January 1, 2006, when Medicare Part D begins, Medicare has three Parts: A, B, and C.

### **Part A- Hospital/Facility**

Medicare Part A includes coverage of inpatient hospital, skilled nursing, home health care, hospice, and blood. There is generally no enrollee premium if a person paid Medicare taxes while working. Enrollee cost sharing is a deductible of \$876 per inpatient stay/benefit period (up to 60 days); after 60 days there is a per-day cost-sharing amount. Skilled nursing facilities are also covered with a copay on stays between 21 and 100 days.

### **Part B- Outpatient**

Medicare Part B includes coverage of outpatient, professional, limited preventive care, and some injectable and physician-administered drugs. The 2004 enrollee monthly premium is \$66.60 and the 2005 monthly enrollee premium will be \$78.20. For 2004 Part B has an annual deductible of \$100 and 20 percent coinsurance (50 percent for outpatient mental health). There is no out of pocket maximum. MMA made changes that index the Part B deductible to inflation. The Part B deductible in 2005 is set as \$110, and it will be updated annually by the same percentage as the Part B premium. Part B premium subsidies are linked to income. MMA also adds preventive benefits to Part B in 2005 including: initial routine physical exam, cardiovascular blood screening tests, and diabetes screening tests and services.

### **Part C- Medicare Advantage**

Medicare Advantage (formerly Medicare + Choice) is Medicare's risk product, offering integrated Part A and B benefits through contracts with private risk-bearing health plans. Members must enroll in both Parts A and B, and pay premiums directly to CMS.

### **The New Part D: Benefit Summary**

MMA created Part D of Medicare, an optional pharmacy benefit available to all Medicare beneficiaries (A and/or B). Beneficiaries may stay in traditional Medicare and get the drug benefit through a drug only plan (Prescription Drug Plan or PDP); or may enroll in a Medicare Advantage Plan that will provide comprehensive coverage for Medicare Parts A, B, and D (Medicare Advantage Prescription Drug plan or MA-PD). Part D enrollment is optional, but if a Medicare beneficiary defers enrollment in Part D, the enrollee will face an enrollment penalty at the time of Part D enrollment if the enrollee did not maintain "creditable" pharmacy coverage in lieu of signing up when first eligible for Medicare Part D.

Part D has a standard benefit design that must be available in all regions and that serves as the basis for all actuarial equivalence tests. PDPs and MA-PDs may offer enhanced benefit designs. The standard benefit design includes: an initial deductible

of \$250 per enrollee; enrollee coinsurance of 25 percent up to \$2,250 in drug spend; 100 percent enrollee coinsurance between \$2,250, and \$5,100 in drug spend (donut hole), and 5 percent enrollee coinsurance once drug spend exceeds \$5,100 (catastrophic level). In this design, drug spend includes Part D covered drugs only, net of all rebates.

The enrollee cost sharing under this model is, by law, termed "True Out of Pocket Cost" (TrOOP). The catastrophic level of coverage does not start for enrollees until they have spent \$3,600 in out-of-pocket costs (\$250 deductible, plus \$500 of 25 percent coinsurance, plus \$2,850 in donut hole= \$3,600). The Part D premium is not included in the TrOOP amount. No amounts paid by third parties count toward the TrOOP Cost limit of \$3,600. If a beneficiary is receiving supplemental help from a third-party insurer, the practical effect of the TrOOP will be to delay the start of the catastrophic benefit. Recall that for the standard drug benefit, beneficiaries reach the \$3,600 limit when they have \$5,100 in total drug spending. If, for example, a supplemental insurer chooses to "fill in the donut" by paying 75 percent of beneficiaries' costs in the coverage gap, then the catastrophic coverage begins at \$13,650 in total drug spending. In all cases the beneficiary is really paying \$3,600 prior to the start of the catastrophic coverage, with Medicare and the supplemental payer picking up the rest.

The estimated enrollee premium for Part D in 2006 is approximately \$35 per member per month. This amount will increase each year. And, as stated earlier, premiums may be higher (premium penalty) for late enrollees who go without creditable pharmacy coverage.

### **Employer Options for Part D Coordination**

The proposed regulations outline several options for employers to coordinate with Part D for retiree pharmacy coverage.

#### *Contract with a PDP or MA-PD*

Under this option an employer would contract directly with a PDP or an MA-PD to provide pharmacy coverage to retirees. Retirees would enroll in Part D that could be paid for either by the enrollee or the employer.

#### *Provide Supplemental Coverage- Secondary Payer*

Under this option, Medicare Part D would be the primary payer for prescription drugs, and the retiree plan would supplement Part D as a secondary payer, similar to current coordination with Medicare Parts A and B. Retirees would enroll in Part D that could be paid for either by the enrollee or the employer.

#### *Collect an Employer Subsidy*

Under this option, the employer would collect a special employer subsidy from CMS. Provisions for the employer subsidy are included in the MMA and the proposed regulations. The subsidy amount will be calculated based on 28 percent of total drug spend between \$250 and \$5,000 net of rebates at the individual retiree level for

Medicare retirees not enrolled in Part D. To be eligible for the employer subsidy, an employer's retiree health plan must meet an actuarial equivalency test determining that the retiree health plan's pharmacy benefit is actuarially equivalent to the Part D standard benefit. The proposed regulations provide multiple possible actuarial equivalence tests.

The first test, least restrictive and least likely to be adopted in final regulations, is a gross test comparing total expected claims under employer plan to total expected claims under standard Part D. This test is unlikely to be successful given CMS' commitment to avoid "employer windfalls." An employer windfall would occur if an employer was able to collect the special employer subsidy, but make no or minimal contribution toward the retirees' pharmacy benefit.

The first test, described above, is also the test for whether a plan provides "creditable" pharmacy coverage. If a plan passes this test, retirees who maintain this coverage and do not enroll in Part D will not face a premium penalty if they later enroll in Medicare Part D.

The second test is a net value test comparing the employer financed portion of expected claims to CMS' estimated average per retiree employer subsidy (\$611/yr in 2006). This test is a middle of-the-road option that considers employer financing of retiree pharmacy coverage, but creates a standard for comparison that more plans will be able to meet. The test would avoid scenarios where employers get more in the employer subsidy than they spend on their retirees' pharmacy benefit.

The third and most conservative actuarial equivalence test is a net value test comparing the employer financed portion of expected claims to the net value of Part D benefits less Part D premiums. HCA's consulting actuary, Mercer, believes that this is the most likely outcome in the final regulations.

### *Employer becomes a PDP or MA-PD*

Under this option, an employer can become a PDP or MA-PD by gaining appropriate licensure from the Insurance Commissioner and submitting a bid to CMS. This option is the least well defined by CMS and has unknown restrictions and outcomes, and would require great reform.

MMA included reform of Medicare Supplemental plans in addition to creating Part D. New MedSup policies issued January 1, 2006, will not include a pharmacy benefit. Individuals selecting a MedSup plan may get a pharmacy benefit through enrollment in Part D. Of the two MedSup plans offered by PEBB, only one, plan J, includes a pharmacy benefit. A recommendation for HCA's response to Medicare Supplemental policy changes will be conveyed under a separate issue paper, but it is important in the context of this paper to understand that there will be no coordination with Part D in the MedSup products. The coordination options for employers with Part D are mostly irrelevant to MedSup policies since they will not include a pharmacy benefit.

## Appendix B

### Washington Statutes Governing Local Government PEBB Participation and Retiree Health Insurance Coverage

#### RCW 41.04.205

Participation of county, municipal, and other political subdivision employees in state employees' insurance or self-insurance and health care program -- Transfer procedure.

(1) Notwithstanding the provisions of RCW 41.04.180, the employees, with their dependents, of any county, municipality, or other political subdivision of this state shall be eligible to participate in any insurance or self-insurance program for employees administered under chapter 41.05 RCW if the legislative authority of any such county, municipality, or other political subdivisions of this state determines, subject to collective bargaining under applicable statutes, a transfer to an insurance or self-insurance program administered under chapter 41.05 RCW should be made. In the event of a special district employee transfer pursuant to this section, members of the governing authority shall be eligible to be included in such transfer if such members are authorized by law as of June 25, 1976, to participate in the insurance program being transferred from and subject to payment by such members of all costs of insurance for members.

(2) When the legislative authority of a county, municipality, or other political subdivision determines to so transfer, the state health care authority shall:

- (a) Establish the conditions for participation; and
- (b) Have the sole right to reject the application.

Approval of the application by the state health care authority shall effect a transfer of the employees involved to the insurance, self-insurance, or health care program applied for.

(3) Any application of this section to members of the law enforcement officers' and fire fighters' retirement system under chapter 41.26 RCW is subject to chapter 41.56 RCW.

(4) School districts may voluntarily transfer, except that all eligible employees in a bargaining unit of a school district may transfer only as a unit and all nonrepresented employees in a district may transfer only as a unit.

[1995 1st sp.s. c 6 § 8; 1993 c 386 § 3; 1992 c 199 § 1; 1990 c 222 § 1; 1988 c 107 § 17; 1975-'76 2nd ex.s. c 106 § 1.]

**RCW 41.04.208**

Local government retirees -- Health care -- Definitions -- Participation--Exception.

(1) Unless the context clearly requires otherwise, the definitions in this subsection apply throughout this section.

(a) "Disabled employee" means a person eligible to receive a disability retirement allowance from the Washington Law Enforcement officers' and Firefighters' Retirement System Plan 2 and the Public Employees' Retirement System.

(b) "Health plan" means a contract, policy, fund, trust, or other program established jointly or individually by a county, municipality, or other political subdivision of the state that provides for all or a part of hospitalization or medical aid for its employees and their dependents under RCW 41.04.180.

(c) "Retired employee" means a public employee meeting the retirement eligibility, years of service requirements, and other criteria of the Washington Law Enforcement Officers' and Firefighters' Retirement System Plan 2 and the Public Employees' Retirement System.

(2) A county, municipality, or other political subdivision that provides a health plan for its employees shall permit retired and disabled employees and their dependents to continue participation in a plan subject to the exceptions, limitations, and conditions set forth in this section. However, this section does not apply to a county, municipality, or other political subdivision participating in an insurance program administered under chapter 41.05 RCW if retired and disabled employees and their dependents of the participating county, municipality, or other political subdivision are covered under an insurance program administered under chapter 41.05 RCW. Nothing in this subsection or chapter 319, Laws of 2002, precludes the local government employer from offering retired or disabled employees a health plan with a benefit structure, copayment, deductible, coinsurance, lifetime benefit maximum, and other plan features which differ from those offered through a health plan provided to active employees. Further, nothing in this subsection precludes a local government employer from joining with other public agency employers, including interjurisdictional benefit pools and multi-employer associations or consortiums, to fulfill its obligations under chapter 319, Laws of 2002.

(3) A county, municipality, or other political subdivision has full authority to require a person who requests continued participation in a health plan under subsection (2) of this section to pay the full cost of such participation, including any amounts necessary for administration. However, this subsection does not require an employer who is currently paying for all or part of a health plan for its retired and disabled employees to discontinue those payments.

(4) Payments for continued participation in a former employer's health plan may be assigned to the underwriter of the health plan from public pension benefits or may be paid to the former employer, as determined by the former employer, so that an underwriter of the health plan that is an insurance company, health care service contractor, or health maintenance organization is not required to accept individual payments from persons continuing participation in the employer's health plan.

(5) After an initial open enrollment period of ninety days after January 1, 2003, an employer may not be required to permit a person to continue participation in the health plan if the person is responsible for a lapse in coverage under the plan. In addition, an employer may not be required to permit a person to continue participation in the employer's health plan if the employer offered continued participation in a health plan that meets the requirements of chapter 319, Laws of 2002.

(6) If a person continuing participation in the former employer's health plan has medical coverage available through another employer, the medical coverage of the other employer is the primary coverage for purposes of coordination of benefits as provided for in the former employer's health plan.

(7) If a person's continued participation in a health plan was permitted because of the person's relationship to a retired or disabled employee of the employer providing the health plan and the retired or disabled employee dies, then that person is permitted to continue participation in the health plan for a period of not more than six months after the death of the retired or disabled employee. However, the employer providing the health plan may permit continued participation beyond that time period.

(8) An employer may offer one or more health plans different from that provided for active employees and designed to meet the needs of persons requesting continued participation in the employer's health plan. An employer, in designing or offering continued participation in a health plan, may utilize terms or conditions necessary to administer the plan to the extent the terms and conditions do not conflict with this section.

(9) If an employer changes the underwriter of a health plan, the replaced underwriter has no further responsibility or obligation to persons who continued participation in a health plan of the replaced underwriter. However, the employer shall permit those persons to participate in any new health plan.



(10) The benefits granted under this section are not considered a matter of contractual right. Should the legislature, a county, municipality, or other political subdivision of the state revoke or change any benefits granted under this section, an affected person is not entitled to receive the benefits as a matter of contractual right.

(11) This section does not affect any health plan contained in a collective bargaining agreement in existence as of January 1, 2003. However, any plan contained in future collective bargaining agreements shall conform to this section. In addition, this section does not affect any health plan contract or policy in existence as of January 1, 2003. However, any renewal of the contract or policy shall conform to this section.

(12) Counties, municipalities, and other political subdivisions that make a documented good faith effort to comply with the provisions of subsections (2) through (11) of this section and are unable to provide access to a fully insured group health benefit plan are discharged from any obligations under subsections (2) through (11) of this section but shall assist disabled employees and retired employees in applying for health insurance. Assistance may include developing and distributing standardized information on the availability and cost of individual health benefit plans, application packages, and health benefit fairs.

(13) The office of the insurance commissioner shall make available to counties, municipalities, and other political subdivisions information regarding individual health benefit plans, including a list of carriers offering individual coverage, the rates charged, and how to apply for coverage.

[2004 c 173 § 1; 2002 c 319 § 2.]

### NOTES:

Effective date -- 2004 c 173: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately [March 26, 2004]." [2004 c 173 § 3.]

Intent -- 2002 c 319: "It is the intent of this act to provide retirees of local government employers access to health care benefits. It is also the intent of this act that local government employers be allowed the flexibility to design programs to meet the health care needs of their retirees and that the local government employer be able to recover all costs associated with providing retirees access to health benefits." [2002 c 319 § 1.]

## **Appendix C**

### **Actuarial Equivalency Tests**

#### **Actuarial Attestation**

In order to collect the subsidy, a sponsor must submit an actuarial attestation to CMS annually, even if the employer provided coverage has not changed. Sponsors can submit attestations from outside actuaries or from actuaries employed by their insurance carriers, pharmacy benefit managers (PBMs) or TPAs. The actuary must attest that the actuarial gross and net values of the employer's retiree prescription drug coverage for the plan year is at least equal to the actuarial gross and net values of standard coverage under Medicare Part D. The final regulations provide further detail about determining actuarial equivalence.

#### **Gross Value Test**

Under the gross value test, the expected amount of paid claims under the employer plan and Medicare Part D must be at least equal. The expected amount of paid claims under the employer's plan must be based on actual claims experience and demographic data for Part D Eligibles.

#### **Net Value Test**

The net value test starts with the gross value of coverage and then takes into account who pays for the retiree prescription drug coverage. The net value of coverage under the employer plan is determined by reducing the gross value of coverage by the expected amount retirees will pay for the coverage. The net value of coverage under Medicare Part D is determined by reducing the gross value of coverage by the expected amount retirees will pay for the coverage and the value of supplemental coverage.

The reduction in net value of coverage under Medicare Part D for supplemental coverage occurs for the following reason. Employees are entitled to catastrophic coverage under Part D after they have true out-of-pocket (TrOOP) costs of \$3,600 (in 2006). Amounts paid by an employer-provided supplemental plan are not considered out of pocket and are not counted toward TrOOP costs. Thus, employees with employer-provided supplemental coverage will have to generate more costs than employees without supplemental coverage to become entitled to catastrophic coverage. Providing supplemental coverage theoretically

makes Medicare Part D coverage less valuable. By reducing the value of Medicare Part D coverage by the value of supplemental coverage, the value of employer-provided coverage will be greater and it will be easier for employers to provide an actuarial equivalent benefit.

### **Plans with several benefit options**

The gross value of coverage must be determined separately for each benefit option for which a sponsor requests a subsidy. The net value may be determined either separately for each benefit option or in the aggregate for all benefit options within the plan that satisfy the gross test.

Source: BNA Tax Management, By Joy Sellstrom, Esq., Seyfarth Shaw, LLP, Chicago, IL

# Select Committee on Pension Policy

## TRS Out-of-State Service Credit

(August 3, 2005)

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### **Issue**

The issue before the SCPP is whether to continue to propose legislation allowing eligible members of the Teachers' Retirement System (TRS) Plans 2 and 3 to purchase up to seven years of membership service credit for public education experience as a teacher in a public school in another state or with the federal government.

### **Staff**

Laura Harper, Senior Research Analyst/Legal  
(360) 586-7616

### **Members Impacted**

This proposal impacts eligible members of TRS Plans 2 and 3. We estimate that 1,236 TRS 2 members out of 7,470 active TRS 2 members, and 26,803 TRS 3 members out of 49,302 active TRS 3 members could be affected by this bill.

### **Current Situation**

Currently, members of TRS may use out-of-state service credit solely for the purpose of determining the time at which the member may retire. The service credit is not purchased and it is not membership service. The member's benefit is actuarially reduced to recognize the difference between the age a member would have first been able to retire based on service in the State of Washington and the member's retirement age using the out-of-state service credit.

### **Procedural Posture/Executive Committee Recommendation**

As the result of the September 7, 2004, briefing of the SCPP on the issue of Age 65 Retirement, an "age 65 subgroup" was formed to make specific recommendations to the SCPP. In the fall of 2004, the subgroup recommended to the Executive Committee that the SCPP consider legislation to provide eligible members of TRS Plans 2/3 the opportunity to purchase up to seven years of out-of-state service credit as membership service, with conditions as set forth in the description below. The Executive Committee directed staff to prepare a bill draft and fiscal note on the proposal and the full Committee approved the proposed legislation for introduction in the 2005 legislative session.

In the 2005 session, the SCPP's bill was introduced as HB 1322/SB 5489. The bill did not move from House Appropriations and did not receive a hearing in Senate Ways and Means. The 2005 fiscal note indicated a total employer cost of \$4.5 million in 2005-2007, \$5.1 million in 2007-2009, and \$130.4 million through 2030. At its July 2005 meeting, the Executive Committee recommended that this issue be brought back to the full committee for consideration on August 23, 2005.

### **2005 SCPP Legislative Proposal**

#### ***Eligibility***

1. This proposal impacts the Teachers' Retirement System (TRS) by allowing members of Plans 2 and 3 to make a one-time purchase of up to seven years of service credit for public education experience (state and federal) outside the Washington State Retirement System.
2. The public education experience claimed must have been covered by a governmental retirement or pension plan and the member must not be receiving or eligible to receive an unreduced retirement benefit that includes the service to be purchased.
3. To take advantage of this provision, a member must have between five and ten years of service credit in TRS.

4. The purchase cannot result in the purchase of service credit that is greater than the member's total years of creditable service in the retirement system.
5. The service credit purchased is membership service and may be used to qualify the member for retirement.

### **Cost to Member**

1. The member pays the product of the sum of the applicable employer and employee contribution rates multiplied by the member's salary at the time of purchase and further multiplied by the total number of years of service credit to be purchased, plus compounded interest for the period for which the service credit is purchased at a rate equal to the investment rate of return assumption set forth in the actuarial funding chapter, Chapter 41.45 RCW:

$(\text{Employer rate} + \text{employee rate}) \times \text{salary} \times \text{years of service} + \text{compounded interest (8 percent)}$

The applicable employer and employee contribution rates are based on the member's age at entry into TRS and calculated under the entry age normal cost method.

2. All or part of the cost may be paid by a rollover or transfer from an eligible retirement plan and the employer may pay all or a portion of the member's cost.

### **Policy Analysis**

This proposal provides a benefit to the TRS Plans 2 and 3 that is not available in the SERS or PERS Plans 2/3, nor will it be available in PSERS Plan 2. The proposal is inconsistent with the legislative policy that the retirement systems of the state shall provide similar benefits wherever possible. See RCW 41.50.005(1). If it were passed by the legislature, this proposal could lead to "leapfrogging" in that members of other retirement systems may seek similar or improved service credit purchase opportunities in the future. Proponents of this legislation have argued that the teaching profession has a unique need for this benefit in order to assist in recruitment and retention of teachers.

It should be noted that TRS members have another service credit option that PERS and SERS members do not have and PSERS members will not have: the ability to elect to apply service credit earned in an out-of-state retirement system that covers teachers in public schools solely for the purpose of determining the time at which the member may retire. See RCW 41.32.065. TRS members are not required to pay for the out-of-state credit, as it is not used to increase the amount of their benefit.

As of July 1, 2006, all Plan 2/3 members in PERS, SERS and TRS will have the ability at retirement to make a one-time purchase of up to five years of additional service credit (or "air time") in order to offset the required benefit reductions for early retirement. (This ability has not been made available to members of PSERS Plan 2, who have an earlier retirement age for unreduced benefits than members of the Plans 2/3 of PERS and SERS.) There is no cost for this option because the purchase price for "air time" is the actuarial cost, which is paid in full by the member. Since the purchase occurs late in the member's career (at early retirement), the member's cost is higher than it would be early in a member's career. In any event, this benefit is relevant to the out-of-state service credit purchase issue in that members of these plans who have prior service credit from another state could use retirement moneys from those other plans to help purchase "air time."

### **Comparative Systems**

According to a December 7, 2000, report to the Connecticut General Assembly, nearly all teacher retirement plans allow members to purchase credit for out-of-state teaching service, but most impose limits on such purchases. Among the most common are limits on the number of years of service a member can purchase, requiring the member to have a minimum number of years in the state plan before (s)he can purchase other service and limiting purchases to service for which the member will receive no other pension.

The following table summarizes two aspects of out-of-state service credit purchase provisions for teachers using Washington's comparative systems: 1) the maximum number of years that can be purchased, and 2) member cost:

| State/System  | Maximum Number of Years  | Member Cost  |
|---------------|--|--|
| CalSTRS       | No limit   | Years x special contribution rate with age factor x highest earnable compensation during last three years  |
| Colorado PERA | No limit   | Actuarial cost   |
| Florida       | 10 years   | 20% of annual compensation for first full year of service in FL but not less than \$12,000, plus interest @ 6.5% compounded annually from date of first annual salary until full payment; employer may pay all or part of the cost |
| Idaho         | 4 years  | Actuarial cost   |
| Iowa          | No limit   | Actuarial cost   |
| Minnesota TRA | Not allowed  |  |
| Missouri PSRS | No more than total service credit earned                               | Highest annual salary x current contribution rate (ER + EE) = cost for one year of service credit  |
| Ohio STRS     | Lesser of 5 years or member's total years of service                   | 50% of actuarial cost  |
| Oregon        | 4 years  | Actuarial cost   |
| Wisconsin     | Limited to number of years of participation in WRS at time of purchase | Actuarial cost   |

For additional resources, see the results of the National Council on Teacher Retirement Portability Study (1999 and 2001 update), [www.nctr.org](http://www.nctr.org). See also the National Education Association's publication entitled "Characteristics of Large Public Education Pension Plans" (2004), [www.nea.org](http://www.nea.org).

### **2005 Bill Authorizing TRS Out-of-State Service Credit (Attached)**

HB 1322/SB 5489 was introduced in the 2005 legislative session and is technically alive for the 2006 session.

### **Draft Fiscal Note (Attached)**

### **Stakeholder Input (Attached)**





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MAY 17 2004

Office of  
The State Actuary

May 13, 2004

Senator Shirley Winsley  
Chair, Select Committee on Pension Policy  
P O Box 40914  
Olympia, WA 98504-0914

Dear Senator Winsley:

The Washington School Personnel Association has a growing concern with Plan 3 retirement systems. Our primary focus is the Teachers Retirement System (TRS), however the challenges and concerns are equally applicable to School Employees' Retirement System (SERS) and Public Employees Retirement System (PERS). We very much appreciate the commitment by the Select Committee to study this issue ("Working Until Age 65") during the 2004 interim. The purpose of this letter is to offer a study guideline for your consideration.

As structured, an employee must effectively work to age 65 to qualify for a viable retirement. For teachers, this means remaining in the classroom for forty to forty-five (40-45) years after acquiring a basic education degree. While teachers are lifelong learners, the expectation of maintaining a viable mastery of knowledge over such a pro-longed period of time is overwhelming. Further, the age requirement fails to appreciate the rigors of performing the duties of a classroom teacher over such an extended period.

We recognize that in designing Plan 3, legislatures acted on the assumption that the defined benefit portion of the retirement plan (1% per year) would become secondary to the defined contribution (investment) in value, and that the added portability of the investment portion would provide an attractive alternative to those leaving service before age 65. It is interesting to note that recent news articles state that participation in 401K plans decreased 2.5% in 2002 and another 3.6% in 2003, and currently rests at 72.6% participation. The same source noted that 42% of workers must cash out their 401K investment when changing jobs. We see this as a more than a transition. Clearly employees recognize that the investment returns of the 1990's were an anomaly that is not likely to be repeated in the future. Consequently, a viable defined benefit is essential to the total compensation package necessary to attract and retain quality educators.

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Debbie Leighton, Auburn

Region V  
Greg Roberts, South Kitsap

Region VI  
Debby Carter, Edmonds

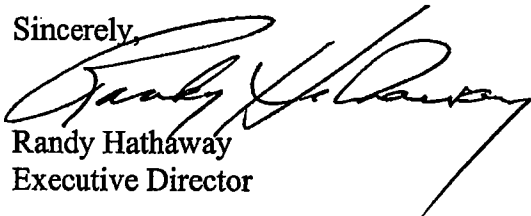
In today's environment and the foreseeable future, 1% per year (30% over three years) is not a viable amount. This is particularly critical, when one considers the severity of the penalty for early retirement. A teacher retiring at age 55 with 30 years of services would only be entitled to 70% of their average earnings for a net benefit of 21% for 30 years of service. The same employee with 29 years of service would be subject to an actuarial reduction instead of a fixed 3% reduction and would only receive 37% of their defined benefit, or 11.1%. With these parameters, working to age 65 becomes mandatory; not an option.

A final, and extremely significant, concern with Plan 2 and 3 is the inability to purchase service credit for out of state service. School Districts increasingly conduct interstate recruiting. Teachers who are vested in another state and who have no opportunity to purchase service credit in Washington State are increasingly less likely to consider a transfer. A purchase option must be available and affordable. Prior provisions for purchasing out of state service credit (i.e., Plan 1) required that the employee pay the full actuarial value for such credit. This rendered it unaffordable. The example used in DRS Information Sheets discloses that an employee earning \$50,000, who is 50 years of age, who purchases 3 years of service credit will be required to pay \$34,159 dollars. In a recruitment and retention perspective, the objective is not zero cost to the State of Washington. Rather, it is treating the experience as though it had been earned in Washington in exchange for the commitment to future Washington employment.

We understand that resolving these concerns has significant cost considerations. However, in that regard, we note that the Washington State contribution to employee retirement in TRS 3 has declined from 11.94% in 1999 to 1.39% in 2003. While this helped balance budget deficits during difficult years, it did so by removing the funding capacity from the retirement system that would have allowed for necessary changes. We believe that with difficult times beginning to move to the past, it should be a legislative priority to restore this "borrowed" funding capacity. We believe new funding ideas, as well as restoration of state contributions, are necessary to create an affordable and financially viable system for both the State and the employee.

We ask that the State Actuary consider alternatives to the above considerations in the conduct of the interim study. As always, the Association, representing School District Human Resource professionals across the State, appreciates the positive and supportive position taken by the Select Committee and the preceding Joint Pension Policy Committee.

Sincerely,



Randy Hathaway  
Executive Director

cc: Barb Mertens, WASA

## TRS Out-of-State Service Credit

1        AN ACT Relating to purchasing service credit in plan 2 and plan 3  
2        of the teachers' retirement system for public education experience  
3        performed as a teacher in a public school in another state or with the  
4        federal government; adding new sections to chapter 41.32 RCW; and  
5        providing an effective date.

6        BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

7        NEW SECTION.    **Sec. 1.** A new section is added to chapter 41.32 RCW  
8        under the subchapter heading "plan 2" to read as follows:

9        (1) An active member who has completed a minimum of five years of  
10        creditable service in the teachers' retirement system may, upon written  
11        application to the department, make a one-time purchase of up to seven  
12        years of service credit for public education experience outside the  
13        Washington state retirement system, subject to the following  
14        limitations:

15        (a) The public education experience being claimed must have been  
16        performed as a teacher in a public school in another state or with the  
17        federal government;

18        (b) The public education experience being claimed must have been

1 covered by a retirement or pension plan provided by a state or  
2 political subdivision of a state, or by the federal government;

3 (c) The member is not currently receiving a benefit or currently  
4 eligible to receive an unreduced retirement benefit from a retirement  
5 or pension plan of a state or political subdivision of a state or the  
6 federal government that includes the service credit to be purchased;

7 (d) The member has less than ten years of creditable service in the  
8 retirement system; and

9 (e) The purchase will not result in the purchase of service credit  
10 years that exceed the member's total years of creditable service in the  
11 retirement system at the time of purchase.

12 (2) The service credit purchased shall be membership service, and  
13 may be used to qualify the member for retirement.

14 (3) The member shall pay the product of the sum of the employer and  
15 employee contribution rates multiplied by the member's annualized  
16 salary at the time of purchase and further multiplied by the total  
17 number of years of service credit to be purchased, plus compounded  
18 interest for the period for which the service credit is purchased at a  
19 rate equal to the investment rate of return assumption set forth in  
20 chapter 41.45 RCW. Compounded interest shall be applied to each year  
21 of service credit purchased as follows: No interest for the first  
22 year, one years' interest for the second year, two years' interest for  
23 the third year, three years' interest for the fourth year, four years'  
24 interest for the fifth year, five years' interest for the sixth year,  
25 and six years' interest for the seventh year. The applicable employer  
26 and employee contribution rates shall be based on the member's age at  
27 entry into the retirement system and calculated under the entry age  
28 normal cost method.

29 (4) The member may pay all or part of the cost of the service  
30 credit to be purchased with a lump sum payment, eligible rollover,  
31 direct rollover, or trustee-to-trustee transfer from an eligible  
32 retirement plan. The department shall adopt rules to ensure that all  
33 lump sum payments, rollovers, and transfers comply with the  
34 requirements of the internal revenue code and regulations adopted by  
35 the internal revenue service. The rules adopted by the department may  
36 condition the acceptance of a rollover or transfer from another plan on  
37 the receipt of information necessary to enable the department to

determine the eligibility of any transferred funds for tax-free rollover treatment or other treatment under federal income tax law.

(5) The employer may pay all or a portion of the member's cost of the service credit purchased under this section.

NEW SECTION. **Sec. 2.** A new section is added to chapter 41.32 RCW under the subchapter heading "plan 3" to read as follows:

(1) An active member who has completed a minimum of five years of creditable service in the teachers' retirement system may, upon written application to the department, make a one-time purchase of up to seven years of service credit for public education experience outside the Washington state retirement system, subject to the following limitations:

(a) The public education experience being claimed must have been performed as a teacher in a public school in another state or with the federal government;

(b) The public education experience being claimed must have been covered by a retirement or pension plan provided by a state or political subdivision of a state, or by the federal government;

(c) The member is not currently receiving a benefit or currently eligible to receive an unreduced retirement benefit from a retirement or pension plan of a state or political subdivision of a state or the federal government that includes the service credit to be purchased;

(d) The member has less than ten years of creditable service in the retirement system; and

(e) The purchase will not result in the purchase of service credit years that exceed the member's total years of creditable service in the retirement system at the time of purchase.

(2) The service credit purchased shall be membership service, and may be used to qualify the member for retirement.

(3) The member shall pay the product of the employer contribution rate multiplied by the member's annualized salary at the time of purchase and further multiplied by the total number of years of service credit to be purchased, plus compounded interest for the period for which the service credit is purchased at a rate equal to the investment rate of return assumption set forth in chapter 41.45 RCW. Compounded interest shall be applied to each year of service credit purchased as follows: No interest for the first year, one years' interest for the

1 second year, two years' interest for the third year, three years'  
2 interest for the fourth year, four years' interest for the fifth year,  
3 five years' interest for the sixth year, and six years' interest for  
4 the seventh year. The total amount paid by the member shall be deemed  
5 a contribution on behalf of the employer for the purpose of RCW  
6 41.32.867, and shall not be refundable. The applicable employer  
7 contribution rate shall be based on the member's age at entry into the  
8 retirement system and calculated under the entry age normal cost  
9 method.

10 (4) The member may pay all or part of the cost of the service  
11 credit to be purchased with a lump sum payment, eligible rollover,  
12 direct rollover, or trustee-to-trustee transfer from an eligible  
13 retirement plan. The department shall adopt rules to ensure that all  
14 lump sum payments, rollovers, and transfers comply with the  
15 requirements of the internal revenue code and regulations adopted by  
16 the internal revenue service. The rules adopted by the department may  
17 condition the acceptance of a rollover or transfer from another plan on  
18 the receipt of information necessary to enable the department to  
19 determine the eligibility of any transferred funds for tax-free  
20 rollover treatment or other treatment under federal income tax law.

21 (5) The employer may pay all or a portion of the member's cost of  
22 the service credit purchased under this section.

23 NEW SECTION. **Sec. 3.** This act takes effect January 1, 2007.

--- END ---

# DRAFT FISCAL NOTE

REQUEST NO.

| RESPONDING AGENCY:          | CODE: | DATE:   | BILL NUMBER: |
|-----------------------------|-------|---------|--------------|
| Office of the State Actuary | 035   | 10/6/05 | Z-0785.1     |

## SUMMARY OF BILL:

This bill impacts the Teachers' Retirement System (TRS) by allowing members of Plans 2 and 3 to make a one-time purchase of up to seven years of service credit for public education experience (state and federal) outside the Washington State Retirement System. The public education experience claimed must have been covered by a governmental retirement or pension plan, and the member must not be receiving a benefit or eligible to receive an unreduced retirement benefit that includes the service to be purchased. To take advantage of this provision, a member must have at least five and less than ten years of service credit in TRS. The purchase cannot result in the purchase of service credit that is greater than the member's total years of creditable service in the retirement system.

The member pays the product of the sum of the applicable employer and employee contribution rates multiplied by the member's salary at the time of purchase, and further multiplied by the total number of years of service credit to be purchased, plus compounded interest for the period for which the service credit is purchased at a rate equal to the investment rate of return assumption set forth in the actuarial funding chapter, Chapter 41.45 RCW. The applicable employer and employee contribution rates are based on the member's age at entry into TRS and calculated under the entry age normal cost method. All or part of the cost may be paid by a rollover or transfer from an eligible retirement plan, and the employer may pay all or a portion of the member's cost. The service credit purchased is membership service and may be used to qualify the member for retirement.

Effective Date: January 1, 2007

## CURRENT SITUATION:

Currently members of TRS may use out-of-state service credit solely for the purpose of determining the time at which the member may retire. The service credit is not purchased and it is not membership service. The member's monthly benefit is actuarially reduced to recognize the difference between the age the member would have first been able to retire based on service in the State of Washington and the member's retirement age using the out-of-state service credit.

## MEMBERS IMPACTED:

We estimate that 1,236 TRS 2 members out of 7,470 active TRS 2 members, and 26,803 TRS 3 members out of 49,302 active TRS 3 members could be affected by this bill.

We estimate that a typical member impacted by this bill would purchase 1.15 years of out-of-state service. The entry age normal cost rate used to determine the purchase price would vary by the member's entry age. The cost of purchasing 1.15 years of service for a typical member with a salary of \$50,000 would be as follows:

Plan 2 Member:  $\$50,000 \times 11.80\% \times (1 + 1.08(.15)) = \$6,856$

Plan 3 Member:  $\$50,000 \times 5.90\% \times (1 + 1.08(.15)) = \$3,428$

## **ASSUMPTIONS:**

We estimated that the average member would buy 1.15 years of service based on a sample of out-of-state service for 6,850 members. These members had a total of 10,815 years of out-of-state service, or an average of 1.58 years per member. When the service was limited to seven years, the members in the sample had a total of 7,910 years, or an average of 1.15 years.

Plan 2 members pay both the member and the employer rate. Plan 3 members pay the employer rate only. The contributions to purchase Plan 2 service would be included with the regular and refundable Plan 2 member contributions. The contributions to purchase Plan 3 service would not be refundable but would be used to determine the Plan 3 defined benefit. The purchase of the first year has no interest. The second year interest rate is 8 percent.

We included the out-of-state service for the benefit calculation, retirement eligibility, and vesting service. Some of our demographic assumptions such as turnover and step salary increases are service based. Our experience studies to determine these rates are based on TRS service only. For estimating the cost of this bill, we assumed that a member's turnover and merit increases would be based on service with TRS only.

## **FISCAL IMPACT:**

### **Description:**

The member would pay for the cost of the additional service, but the plan would be partially subsidizing the cost because the interest is based on the date of purchase, not on the adjusted date of hire.

### **Actuarial Determinations:**

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:



| <i>(Dollars in Millions)</i>   |  | <b>Teachers' Retirement System Plan 2/3</b> |                 |              |
|--|--|---|-----------------|--------------|
|  |  | <b>Current</b>                              | <b>Increase</b> | <b>Total</b> |
| <b>Actuarial Present Value of Projected Benefits</b>   |  | \$5,256                                     | \$18            | \$5,274      |
| <i>(The Value of the Total Commitment to all Current Members)</i>                              |  |   |                 |              |
| <b>Unfunded Actuarial Accrued Liability</b>  |  | N/A   | N/A             | N/A          |
| <i>(The Portion of the Plan 1 Liability that is Amortized at 2024)</i>                         |  |   |                 |              |
| <b>Unfunded Liability (PBO)</b>  |  | \$(1,427)                                   | \$14            | \$(1,413)    |
| <i>(The Value of the Total Commitment to all Current Members Attributable to Past Service)</i> |  |   |                 |              |

**Increase in Contribution Rates: (Effective 09/01/2006)**

**Current Members**

|                |       |
|----------------|-------|
| Employee       | 0.05% |
| Employer State | 0.05% |

**New Entrants\***

|                |       |
|----------------|-------|
| Employee       | n/a   |
| Employer State | 0.07% |

*\*Rate change applied to future new entrant payroll and used for fiscal budget determinations only. A single supplemental rate increase, equal to the increase for current members, would apply initially for all members or employers.*

## Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures is projected to be:

| <b>Costs (in Millions):</b> | <b><u>TRS 2/3</u></b> |
|-----------------------------|-----------------------|
| <b>2006-2007</b>            |                       |
| <b>State:</b>               |                       |
| General Fund                | \$1.4                 |
| Non-General Fund            | <u>\$0.0</u>          |
| <b>Total State</b>          | <b>\$1.4</b>          |
| Local Government            | \$0.8                 |
| Total Employer              | \$2.2                 |
| Total Employee              | \$0.2                 |
| <b>2007-2009</b>            |                       |
| <b>State:</b>               |                       |
| General Fund                | \$3.3                 |
| Non-General Fund            | <u>\$0.0</u>          |
| <b>Total State</b>          | <b>\$3.3</b>          |
| Local Government            | \$1.6                 |
| Total Employer              | \$4.9                 |
| Total Employee              | \$0.4                 |
| <b>2006-2031</b>            |                       |
| <b>State:</b>               |                       |
| General Fund                | \$88.9                |
| Non-General Fund            | <u>\$0.0</u>          |
| <b>Total State</b>          | <b>\$88.9</b>         |
| Local Government            | \$44.5                |
| Total Employer              | \$133.4               |
| Total Employee              | \$2.8                 |

## STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Teachers' Retirement System. Fiscal Budget Determinations were based on preliminary 2004 data.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:
4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
5. This draft fiscal note is intended for use only during the 2006 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.
8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members. Rate increases are based on rates that exclude the cost of gain sharing.

## GLOSSARY OF ACTUARIAL TERMS:

**Actuarial accrued liability:** Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

**Actuarial Present Value:** The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

**Aggregate Funding Method:** The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

**Entry Age Normal Cost Method (EANC):** The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

**Normal Cost:** Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

**Pension Benefit Obligation (PBO):** The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

**Projected Benefits:** Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

**Unfunded Liability (Unfunded PBO):** The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

**Unfunded Actuarial Accrued Liability (UAAL):** The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

# Select Committee on Pension Policy

## Plan 3 Vesting

(August 1, 2004)

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### Issue

Reduce the required length of service for vesting in the Defined Benefit (DB) portion of the PERS, SERS, and TRS Plans 3 from ten years to five years.

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### Members Impacted

As of the most recent valuation, there were 58,101 Plan 3 members who were not vested. Non-vested members included those who had less than ten years of service; those who were not vested in Plan 2 on July 1, 1996, in TRS; September 1, 2000, in SERS; or June 1, 2003, in PERS; and those who did not have five years of service including 12 months after age 54. Any of these non-vested members would be affected by this proposal unless they leave employment or become vested prior to the effective date of any legislation to change the vesting period.

### Current Situation

New Plan 3 members of TRS, SERS, and PERS are vested in the DB portion of their plan after ten years of service or after five years of service if 12 months of that service is earned after attaining age 54. Plan 3 members are immediately vested in the Defined Contribution (DC) portion of their Plan.

### History

SHB 1298 was introduced in the 2003 legislative session. The bill would have shortened the DB vesting period in the Plans 3 from ten to five years. The bill passed the House, but was not

heard in the Senate. In 2004, similar legislation was introduced as SB 6247/HB 2540. It passed in the Senate, but died in House Appropriations. In 2005, the SCPP recommended SB 5517/HB 1320, which would have made the same change to Plan 3 vesting as had been proposed in 2003 and 2004. A substitute bill passed the House that would have lowered the vesting period from ten to five years only for those members who are age 45 and older. This modification made the bill less costly, however, the substitute bill did not receive a hearing in Senate Ways and Means.

### **Policy Analysis**

The Plans 3 are hybrid plans. The DB portion of these plans (the portion to which the ten-year vesting period applies) uses a formula to determine the monthly retirement benefit that a member will receive for life:  $1\% \times \text{Average Final Compensation (AFC)} \times \text{years of service credit}$ . The defined benefit is funded entirely by employers. When members leave employment prior to becoming vested, they forfeit these employer contributions. On the other hand, the DC portion of the Plans 3 is funded entirely by employees. Employees are immediately vested in their own contributions.

When the Plans 3 were on the drawing board, one of the concerns was the small size of the defined benefit that members would receive if they earned only a modest amount of service credit before full retirement. Plan 2 members receive 10 percent of AFC upon vesting (5 years  $\times$  2% per year). This 10 percent standard was used for the DB portion of the Plans 3. Setting the vesting period in the Plans 3 to ten years guaranteed vested members 10 percent of their AFC as a minimum defined benefit (10 years  $\times$  1% per year).

In the design of the Plans 3, the long vesting period for the DB portion of the pension was offset by the fact that Plan 3 members were immediately vested in the DC portion of their benefit. Since the defined benefit would be such a small portion of the total benefit during the early years of employment, and since members were immediately vested in their employee contributions, it was felt that those who left employment before the end of the vesting period would not be losing such a significant amount of their total retirement benefit that the longer vesting period would adversely affect employment behavior.

The following table illustrates the value of the DB portion of Plan 3 for members who entered the plan at various ages and separated from service after five years. These examples assume an average final compensation of \$30,000 and an annual inflation rate of 3.5 percent.

**Future Value of Plan 3 Benefit, Adjusted for 3.5 percent Assumed Inflation**  
(Defined Benefit payable at 65 = 1% x \$30,000 x 5 years of service)

| Entry Age | Age at Separation | DB Benefit at 65 | Future Value* | % of DB |
|-----------|-------------------|------------------|---------------|---------|
| 25        | 30                | \$1,500          | \$450         | 30%     |
| 35        | 40                | \$1,500          | \$635         | 42%     |
| 45        | 50                | \$1,500          | \$895         | 60%     |
| 55        | 60                | \$1,500          | \$1,263       | 84%     |

*\*Reduced for 3.5 percent assumed annual inflation from age at separation to age 65.*

The table illustrates that for those who are hired at earlier ages, the future benefit that is forfeited due to failure to vest is smaller after adjustment for assumed inflation from age at separation to age 65. This is consistent with the rationale behind the ten-year vesting period and the reason why the vesting period was lowered for older employees. The higher the plan entry age, the greater the percentage of the future benefit that would be forfeited at separation as the result of a failure to vest.

It is unknown whether members actually analyze their own retirement benefits at this level of detail or how much the vesting period is a factor in employment decisions. Theoretically, shorter vesting periods support attraction of new employees. Longer vesting periods support retention of current employees.

Another retention incentive in the Plans 3 is the provision that members who remain in the Plans 3 for at least 20 service-credit years receive the additional benefit of an "inflation protector." These members receive an increase in the DB portion of their retirement allowance of 3 percent per year, compounded for each month from the date of separation to the date that the retirement allowance commences.

## Comparison with Washington Plans and Other States

The ten-year vesting period for the DB portion of the Plans 3 is the longest among the plans administered by Washington State. The Plans 1 and 2, which are all DB and not hybrid plans, have five-year vesting periods.

The national trend in retirement plans is toward shorter vesting periods due to the increasing mobility of the workforce and the trend toward multiple careers. However, numerous state and municipal retirement plans still use a ten-year vesting period. In the **2002 survey from the Public Pension Coordinating Council** covering 276 public retirement plans, a total of 96 plans had vesting requirements of ten years or more. More than 40 of those plans were administered by 25 states or territories in addition to Washington. In comparison, 132 plans had vesting requirements of five years or less. The survey results are attached.

Results of the **Wisconsin Legislative Councils' 2002 Comparative Study of Major Public Employee Retirement Systems** are also attached. According to this report, in 2002 a total of 60 out of 85 plans required five years or less of service to vest, with an increase of six plans in this category since the 2000 report. The number of plans in 2002 that required ten years of service to vest decreased by five plans from the 2000 report and by 20 plans from the 1990 report.

## Options

The proposal to lower the vesting period for the DB portion of the Plans 3 from ten to five years has been considered and rejected during the last three legislative sessions. With that in mind, the Committee may wish to consider alternative approaches to the issue. One possibility is that the proposal was rejected due to cost.

An option for lowering the cost was explored in the development of last session's substitute bill, which proposed a five-year vesting in the higher age bracket (i.e. those 45 and over) when the vesting period is more likely to affect employment behavior. Currently five-year vesting is available in the Plans 3 if 12 months of a member's service is earned after attaining age 54. That age could certainly be lowered to a threshold age of 50 or 45. These options were priced in November 2004 and the results are attached in the document entitled **Plan 3 Vesting Supplemental Summary**.



If the SCPP wishes to pursue the issue of Plan 3 vesting, it might be useful to study the probability of member termination at various ages as well as the value of the DB component of the Plans 3 at various ages in order to better assess whether any changes to the vesting period might affect employment behavior.

If the Committee determines that the cost of changing the vesting period is prohibitive at this time, another option would be to encourage additional member education. There may be a perception that the longer vesting period for the DB portion of the Plans 3 is a detriment to those who might select Plan 3. However, through additional member education, more new hires may be able to better evaluate the financial implications of the vesting period and better understand the tradeoffs in the design of the Plans 3.

### **Stakeholder Input**

Letters requesting that Plan 3 vesting be considered by the SCPP during the 2004 and/or 2005 interim are attached.

### **Executive Committee Recommendation**

At its July 19, 2005, meeting the Executive Committee considered whether to bring this issue back before the full committee. At that time it was decided that the full SCPP should consider the issue at its August 23, 2005, meeting.

### **Bills**

Copies of the SCPP's 2005 bill and the House's substitute for the bill are attached. This SCPP's bill would reduce the required length of service for vesting in the DB portion of PERS, SERS, and TRS Plans 3 from ten years to five years. The substitute bill would do the same, but only for those who are age 45 and older.

### **Fiscal Note**

The two fiscal notes for the 2005 bills are attached. Each bill would increase contribution rates in the PERS, TRS, and SERS Plans 2 and Plans 3, although the substitute bill would do so to a lesser extent. It should be noted that if passed, the cost of this Plan 3 benefit enhancement would be shared equally among Plan 2/3 employers and Plan 2 employees. This cost-sharing approach is defined under state law in the actuarial funding chapter, Chapter 41.45 RCW.

# Active Members and Vesting Requirements by Plan

Source: Public Pension Coordinating Council Survey 2002 (2000-2001 data)

| ID#   | PLAN NAME  | Members | Vesting Requirement                                       |
|-------|--|---------|---|
| 0376G | West Virginia Teacher's Defined Contribution Plan                                    | 19,000  | 1/3 after 6 years; 2/3 after 9 years; 100% after 12 years |
| 0020A | PARK EMPLOYEES & RET. BOARD EMPLOYEES ANNUITY AND BENEFIT FUND OF CHICAGO            | 3,639   | 10 YEARS  |
| 0247A | OAKLAND POLICE & FIRE RETIREMENT FUND  | 161     | 10 YEARS  |
| 0283A | City Pension Fund for Firefighters and Police Officers in the City of Pembroke Pines | 364     | 10 years  |
| 0314C | BISMARCK FIREFIGHTERS RELIEF ASSOCIATION   | 62      | 10 YEARS  |
| 0376D | West Virginia State Police Retirement Plan (Trooper Plan B)                          | 323     | 10 years  |
| 0497B | Macon Water Authority Employee Pension Plan  | 205     | 10 years  |
| 0672A | New York City Pension Fund - Subchapter 2  | 11,477  | 10 years  |
| 0022A | Dukes County Contributory Retirement Plan  | 932     | 10 years at age 55  |
| 0083A | OKLAHOMA TEACHERS' RETIREMENT SYSTEM   | 83,024  | 10 YEARS OF OKLAHOMA SERVICE                              |
| 0006C | RETIREMENT SYSTEMS OF ALABAMA TEACHERS' PLAN   | 126,558 | 10 YEARS OF SERVICE                                       |
| 0010A | TEACHERS' RETIREMENT SYSTEM OF LA - REGULAR EMPLOYEES                                | 87,631  | 10 YEARS OF SERVICE                                       |
| 0010B | TEACHERS' RET. SYSTEM OF LA - SCHOOL FOOD SERVICE PLAN B                             | 2,115   | 10 YEARS OF SERVICE                                       |
| 0010C | TEACHERS' RET. SYSTEM OF LA - SCHOOL FOOD SERVICE PLAN A                             | 1,067   | 10 YEARS OF SERVICE                                       |
| 0038A | RETIREMENT SYSTEM FOR SWORN POLICE PERSONNEL   | 107     | 10 YEARS OF SERVICE                                       |
| 0015A | CONNECTICUT TEACHERS' RETIREMENT SYSTEM  | 46,500  | 10 YEARS OF SERVICE                                       |
| 0016A | PLYMOUTH COUNTY RETIREMENT ASSOCIATION   | 9,098   | 10 YEARS OF SERVICE                                       |
| 0017A | MIAMI FIRE FIGHTERS' AND POLICE OFFICERS' RETIREMENT TRUST                           | 1,587   | 10 YEARS OF SERVICE                                       |
| 0024A | STERLING HEIGHTS POLICE AND FIRE RETIREMENT PLAN                                     | 281     | 10 YEARS OF SERVICE                                       |
| 0084B | EMPLOYEES' RETIREMENT SYSTEM OF GEORGIA - PUBLIC SCHOOL                              | 32,864  | 10 YEARS OF SERVICE                                       |
| 0084C | EMPLOYEES' RETIREMENT SYSTEM OF GEORGIA - JUDICIAL                                   | 416     | 10 YEARS OF SERVICE                                       |
| 0004A | TEXAS MUNICIPAL RETIREMENT SYSTEM  | 86,203  | 10 YEARS OF SERVICE                                       |
| 0005A | RETIREMENT SYSTEMS OF ALABAMA EMPLOYEES  | 75,734  | 10 YEARS OF SERVICE                                       |
| 0064A | EMPLOYEES' RETIREMENT SYSTEM OF GEORGIA - GENERAL                                    | 72,176  | 10 YEARS OF SERVICE                                       |
| 0067A | TEACHERS' PENSION AND ANNUITY FUND OF NEW JERSEY                                     | 134,199 | 10 YEARS OF SERVICE                                       |
| 0068A | POLICE AND FIREMEN'S RETIREMENT SYSTEM OF NEW JERSEY                                 | 42,430  | 10 YEARS OF SERVICE                                       |
| 0069A | PUBLIC EMPLOYEES' RETIREMENT SYSTEM OF NEW JERSEY                                    | 277,441 | 10 YEARS OF SERVICE                                       |
| 0146E | LOS ANGELES COUNTY EMPLOYEES' RET. ASSOC., PLAN E: GENERAL                           | 31,088  | 10 YEARS OF SERVICE                                       |
| 0071A | LOUISIANA STATE EMPLOYEES' RETIREMENT SYSTEM   | 69,880  | 10 YEARS OF SERVICE                                       |
| 0087A | NEW HAMPSHIRE RETIREMENT SYSTEM - GENERAL PLAN/EMPLOYEES                             | 20,262  | 10 YEARS OF SERVICE                                       |
| 0087C | NEW HAMPSHIRE RETIREMENT SYSTEM - POLICE PLAN  | 3,254   | 10 YEARS OF SERVICE                                       |
| 0087D | NEW HAMPSHIRE RETIREMENT SYSTEM - FIREFIGHTERS PLAN                                  | 1,269   | 10 YEARS OF SERVICE                                       |
| 0120A | CITY OF BOCA RATON GENERAL EMPLOYEES' TRUST  | 628     | 10 YEARS OF SERVICE                                       |
| 0131A | MWRD RETIREMENT FUND   | 2,084   | 10 years of service                                       |
| 0148A | TEACHERS RETIREMENT SYSTEM OF GEORGIA  | 191,908 | 10 YEARS OF SERVICE                                       |
| 0154B | NORTH DAKOTA HIGHWAY PATROL RETIREMENT PLAN  | 122     | 10 YEARS OF SERVICE                                       |
| 0158B | WICHITA POLICE AND FIRE RETIREMENT SYSTEM  | 993     | 10 YEARS OF SERVICE                                       |
| 0161A | INDIANA STATE TEACHERS' RETIREMENT PLAN  | 77,870  | 10 YEARS OF SERVICE                                       |
| 0163A | CHICOPEE RETIREMENT SYSTEM   | 1,140   | 10 YEARS OF SERVICE                                       |
| 0168A | FLORIDA RETIREMENT SYSTEM  | 597,823 | 10 YEARS OF SERVICE                                       |
| 0181A | MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM                                  | 312,699 | 10 YEARS OF SERVICE                                       |
| 0182A | MICHIGAN STATE POLICE RETIREMENT SYSTEM  | 2,210   | 10 YEARS OF SERVICE                                       |
| 0185A | MICHIGAN STATE EMPLOYEES' RETIREMENT SYSTEM  | 47,778  | 10 YEARS OF SERVICE                                       |
| 0193A | KANSAS PUBLIC EMPLOYEES RETIREMENT PLAN  | 142,870 | 10 YEARS OF SERVICE                                       |
| 0223A | CITY OF ALPENA - GENERAL   | 48      | 10 YEARS OF SERVICE                                       |
| 0224A | LA COUNTY METRO TRANSIT AUTHORITY - UTU RIP  | 3,944   | 10 YEARS OF SERVICE                                       |
| 0224B | LA COUNTY METRO TRANSIT AUTHORITY - MAINTENANCE EMPLOYEES                            | 2,023   | 10 YEARS OF SERVICE                                       |
| 0224C | LA COUNTY METRO TRANSIT AUTHORITY - TCU RIP  | 697     | 10 YEARS OF SERVICE                                       |
| 0226A | CITY OF MANISTEE EMPLOYEES RETIREMENT SYSTEM   | 62      | 10 YEARS OF SERVICE                                       |
| 0255A | OKLAHOMA POLICE PENSION AND RETIREMENT PLAN  | 3,778   | 10 YEARS OF SERVICE                                       |

|       |   |         |   |
|-------|---|---------|---|
| 0268A | KANSAS CITY (MO) FIREFIGHTERS' PENSION SYSTEM                                       | 781     | 10 YEARS OF SERVICE   |
| 0293A | CITY OF MILFORD - BENEFIT PLAN I  | 700     | 10 YEARS OF SERVICE   |
| 0314A | CITY OF BISMARCK CITY PENSION PLAN  | 307     | 10 YEARS OF SERVICE   |
| 0314B | CITY OF BISMARCK POLICE PENSION PLAN  | 143     | 10 YEARS OF SERVICE   |
| 0335A | LYNN HAVEN POLICE PENSION PLAN  | 27      | 10 YEARS OF SERVICE   |
| 0337A | LYNN HAVEN GENERAL EMPLOYEE PENSION PLAN  | 74      | 10 YEARS OF SERVICE   |
| 0340A | A.S.G GENERAL EMPLOYEES PLAN  | 4,050   | 10 YEARS OF SERVICE   |
| 0372A | EMPLOYEES RETIREMENT SYSTEM OF RHODE ISLAND   | 28,738  | 10 YEARS OF SERVICE   |
| 0372B | MUNICIPAL EMPLOYEES RETIREMENT SYSTEM   | 8,983   | 10 YEARS OF SERVICE   |
| 0372C | STATE POLICE RETIREMENT BENEFITS TRUST  | 130     | 10 YEARS OF SERVICE   |
| 0381A | CITY OF ALAMEDA POLICE AND FIRE RETIREMENT PLAN 1079 (CLOSED TO NEW MEMBERS)        | 0       | 10 YEARS OF SERVICE   |
| 0381B | CITY OF ALAMEDA POLICE & FIRE PLAN 1082 (CLOSED TO NEW MEMBERS)                     | 0       | 10 YEARS OF SERVICE   |
| 0388A | TOWN OF AVON POLICE RETIREMENT PLAN   | 25      | 10 YEARS OF SERVICE   |
| 0408A | ROSEVILLE CITY EMPLOYEE'S RETIREMENT PLAN   | 308     | 10 YEARS OF SERVICE   |
| 0413A | CITY OF CADILLAC POLICEMEN AND FIREMENT RETIREMENT SYSTEM                           | 29      | 10 YEARS OF SERVICE   |
| 0414A | CITY OF BIRMINGHAM (MI) EMPLOYEES RETIREMENT SYSTEM                                 | 197     | 10 YEARS OF SERVICE   |
| 0423A | STATE POLICE RETIREMENT SYSTEM OF NEW JERSEY  | 2,823   | 10 YEARS OF SERVICE   |
| 0425A | PRISON OFFICERS' PENSION FUND OF NEW JERSEY   | 0       | 10 YEARS OF SERVICE   |
| 0437A | CITY OF WHEELING EMPLOYEES' RETIREMENT AND BENEFIT FUND                             | 240     | 10 YEARS OF SERVICE   |
| 0485A | LONG BEACH TRANSIT PENSION PLAN - SALARIED EMPLOYEES                                | 117     | 10 YEARS OF SERVICE   |
| 0788A | VIRGIN ISLANDS GOVERNMENT EMPLOYEES' RETIREMENT PLAN                                | 16,881  | 10 YEARS OF SERVICE   |
| 0072A | ARKANSAS TEACHERS' RETIREMENT SYSTEM  | 58,528  | 10 YEARS OF SERVICE (7/1/98 - 5 YEARS)                                    |
| 0278A | CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM *                                    | 715,105 | 10 YEARS OF SERVICE FOR TIER 2/5 YEARS SERVICE FOR TIER 1                 |
| 0121A | PENNSYLVANIA STATE EMPLOYEES' RETIREMENT SYSTEM                                     | 112,044 | 10 YEARS OF SERVICE OR 3 YEARS AT AGE 80                                  |
| 0235B | NEBRASKA PERS STATE PATROL RETIREMENT PLAN  | 388     | 10 YEARS OF SERVICE, SCHEDULE OF 20% PER YEAR FROM 6-10 YRS               |
| 0057C | WYOMING PAID FIREMEN'S PLAN   | 282     | 10 YEARS OF SERVICE FOR PLAN A; 4 YRS FOR PLAN B                          |
| 0195H | MONTANA VOLUNTEER FIREFIGHTERS COMPENSATION ACT                                     | 2,537   | 10 YRS  |
| 0677A | Springfield Police & Fire Retirement System   | 500     | 10 YRS  |
| 0569A | City of Kingsford Police and Firemen Retirement System                              | 20      | 10 yrs service  |
| 0174I | Washington Teachers' Retirement System - Plan 3                                     | 35,284  | age 65 with at least 10 years of service                                  |
| 0619A | Holyoke Contributory Retirement System  | 1,407   | 10 yrs svr/age 65 20 yrs svr/any age                                      |
| 0124A | CITY OF MIAMI BEACH FIRE & POLICE SUPPLEMENTAL PLAN CITY PENSION FUND.              | 488     | 100% AFTER 10 YEARS   |
| 0497A | Macon Water Authority Employee Pension Plan   | 200     | vested with 10 yrs. service   |
| 0060B | STATE COLLEGE BOROUGH - POLICE PLAN   | 60      | 12 YEARS  |
| 0193B | KANSAS POLICE AND FIRE RETIREMENT SYSTEM  | 6,590   | 15 YEARS  |
| 0407D | FLINT EMPLOYEES RETIREMENT SYSTEM - MEDICAL CENTER                                  | 2,220   | 15 YEARS (10 AT AGE 65)   |
| 0174H | WASHINGTON JUDICIAL RETIREMENT SYSTEM   | 38      | 15 YEARS OF SERVICE   |
| 0418A | POLICE RETIREMENT SYSTEM OF KANSAS CITY, MISSOURI                                   | 1,283   | 15 YEARS OF SERVICE   |
| 0378A | West Virginia Judges Retirement System (JRS)  | 52      | 16 years service  |
| 0183B | State of Michigan Defined Contribution Retirement Plan                              | 234     | 2 years = 50%, 3 years = 75%, 4 yrs = 100%                                |
| 0185B | State of Michigan Defined Contribution Retirement Plan                              | 12,835  | 2 YOS = 50%, 3 YOS = 75%, 4 YOS = 100%                                    |
| 0009A | THE POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO                                 | 13,858  | 20 YEARS  |
| 0019A | OHIO STATE HIGHWAY PATROL RETIREMENT PLAN   | 1,545   | 20 YEARS  |
| 0759A | HOUSTON FIREFIGHTERS' RELIEF AND RETIREMENT FUND                                    | 3,276   | 20 YEARS  |
| 0372D | JUDICIAL RETIREMENT BENEFITS TRUST  | 29      | 20 YEARS AGE 65, OR 15 YEARS AGE 75                                       |
| 0025A | CLAIR T. SINGERMAN EMPLOYEE RETIREMENT SYSTEM                                       | 374     | 20 YEARS AND AGE 65   |
| 0092A | FIRE AND POLICE PENSION FUND, SAN ANTONIO   | 3,500   | 20 YEARS OF SERVICE   |
| 0190A | TEXAS COUNTY AND DISTRICT RETIREMENT PLAN   | 80,633  | 8, 10, OR 12 YEARS, AT PARTICIPATING EMPLOYER'S ELECTION                  |
| 0386A | COLORADO COUNTY OFFICIALS & EMPLOYEES RET. ASSOC. PLANS                             | 15,000  | IMMEDIATE; 5 YR; 10 YR-AS ADOPTED BY COUNTIES, MUNICI., & SPEC. DISTRICTS |
| 0043A | MN STATE RETIREMENT SYSTEM GENERAL EMPLOYEES' PLAN                                  | 47,920  | 3 YEARS   |
| 0043B | MN STATE RETIREMENT SYSTEM STATE TROOPERS' RETIREMENT PLAN                          | 830     | 3 YEARS   |
| 0043C | MN STATE RETIREMENT SYSTEM CORRECTIONAL EMPLOYEES' PLAN                             | 2,882   | 3 YEARS   |
| 0133A | MN PUBLIC EMPLOYEES' RETIREMENT ASSOC. - COORDINATED PLAN                           | 135,560 | 3 YEARS   |
| 0133B | MN PUBLIC EMPLOYEES' RETIREMENT ASSOC. - POLICE & FIRE PLAN                         | 8,827   | 3 YEARS   |
| 0482B | Employees' Retirement System of Montgomery County (DC Plan) Retirement Savings Plan | 2,544   | 3 YEARS   |
| 0405A | MINNESOTA TEACHERS RETIREMENT ASSOCIATION   | 70,508  | 3 YEARS OF ALLOWABLE SERVICE  |

|       |  |         |                              |
|-------|--|---------|------------------------------|
| 0023A | BURLINGTON EMPLOYEES' RET. SYSTEM FOR POLICE AND FIRE                              | 185     | 3 YEARS OF SERVICE           |
| 0023B | BURLINGTON EMPLOYEES' RET. SYSTEM FOR GENERAL EMPLOYEES                            | 534     | 3 YEARS OF SERVICE           |
| 0055A | NORTH DAKOTA TEACHERS' FUND FOR RETIREMENT   | 10,025  | 3 YEARS OF SERVICE           |
| 0178A | SOUTH DAKOTA RETIREMENT SYSTEM   | 34,180  | 3 YEARS OF SERVICE           |
| 0006A | PERS OF MISSISSIPPI GENERAL PLAN   | 151,780 | 4 YEARS                      |
| 0057D | WYOMING PUBLIC EMPLOYEES' SYSTEM   | 31,492  | 4 YEARS                      |
| 0165E | UTAH FIREFIGHTER'S RETIREMENT SYSTEM   | 1,452   | 4 YEARS                      |
| 0165A | UTAH PUBLIC EMPLOYEES' CONTRIBUTORY RETIREMENT SYSTEM                              | 3,972   | 4 YEARS OF SERVICE           |
| 0165B | UTAH PUBLIC EMPLOYEES' NON-CONTRIBUTORY RETIREMENT SYSTEM                          | 81,894  | 4 YEARS OF SERVICE           |
| 0165C | UTAH PUBLIC SAFETY PLAN  | 6,839   | 4 YEARS OF SERVICE           |
| 0165F | UTAH GOVERNORS AND LEGISLATIVE PENSION PLAN  | 88      | 4 YEARS OF SERVICE           |
| 0452A | Municipal Fire & Police Retirement System of Iowa                                  | 3,843   | 4 years of service           |
| 0278B | CALIFORNIA LEGISLATORS' RETIREMENT SYSTEM  | 28      | 4 YEARS OF SERVICE CREDIT    |
| 0066A | EMPLOYEES' RETIREMENT SYSTEM OF TEXAS  | 152,167 | 5 YEARS                      |
| 0376C | West Virginia Public Safety Death, Disability and Retirement Plan (Trooper Plan A) | 360     | 5 years                      |
| 0211A | MENDOCINO COUNTY ERA   | 1,347   | 5 YEARS                      |
| 0278C | JUDGES' RETIREMENT SYSTEM I (JRS I)  | 1,091   | 5 YEARS                      |
| 0378E | West Virginia Teacher's Retirement System (TRS)                                    | 25,278  | 5 years                      |
| 0378F | West Virginia Public Employees Retirement System (PERS)                            | 33,978  | 5 years contributory service |
| 0013A | PA PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM                                      | 234,210 | 5 YEARS OF SERVICE           |
| 0043D | MN STATE RETIREMENT SYSTEM JUDGES' RETIREMENT PLAN                                 | 282     | 5 YEARS OF SERVICE           |
| 0048B | KENTUCKY COUNTY EMPLOYEES' RETIREMENT SYSTEM - NON HAZARDOUS                       | 77,419  | 5 YEARS OF SERVICE           |
| 0048C | KENTUCKY EMPLOYEES' RETIREMENT SYSTEM - HAZARDOUS                                  | 4,007   | 5 YEARS OF SERVICE           |
| 0036A | MISSOURI LOCAL GOVERNMENT EMPLOYEES' RETIREMENT PLAN                               | 28,491  | 5 YEARS OF SERVICE           |
| 0001A | PERS OF NEVADA GENERAL EMPLOYEES' PLAN   | 71,924  | 5 YEARS OF SERVICE           |
| 0001B | PERS OF NEVADA POLICE/FIRE EMPLOYEES' PLAN   | 8,910   | 5 YEARS OF SERVICE           |
| 0003A | SOUTH CAROLINA RETIREMENT SYSTEM - GENERAL PLAN                                    | 204,710 | 5 YEARS OF SERVICE           |
| 0003B | SOUTH CAROLINA RETIREMENT SYSTEM - POLICE OFFICERS' PLAN                           | 24,827  | 5 YEARS OF SERVICE           |
| 0005B | RETIREMENT SYSTEMS OF ALABAMA JUDICIAL PLAN  | 351     | 5 YEARS OF SERVICE           |
| 0048D | KENTUCKY STATE POLICE RETIREMENT SYSTEM  | 1,023   | 5 YEARS OF SERVICE           |
| 0048E | KENTUCKY COUNTY EMPLOYEES' RETIREMENT SYSTEM - HAZARDOUS                           | 7,951   | 5 YEARS OF SERVICE           |
| 0058A | CHATHAM COUNTH EMPLOYEES' RETIREMENT PLAN  | 1,613   | 5 YEARS OF SERVICE           |
| 0060A | STATE COLLEGE BOROUGH - GENERAL PLAN   | 126     | 5 YEARS OF SERVICE           |
| 0062A | PORTLAND FIRE AND POLICE DISABILITY AND RETIREMENT FUND                            | 1,548   | 5 YEARS OF SERVICE           |
| 0147A | PERS OF IDAHO - GENERAL MEMBERS  | 55,287  | 5 YEARS OF SERVICE           |
| 0147B | PERS OF IDAHO - POLICE/FIRE MEMBERS  | 5,091   | 5 YEARS OF SERVICE           |
| 0195G | MONTANA FIREFIGHTERS UNIFIED RETIREMENT SYSTEM                                     | 419     | 5 YEARS OF SERVICE           |
| 0376B | West Virginia Deputy Sheriffs Retirement System (DSRS)                             | 488     | 5 years of service           |
| 0070A | TACOMA EMPLOYEES' RETIREMENT SYSTEM  | 2,814   | 5 YEARS OF SERVICE           |
| 0075A | Defined Benefit Plan for City Employees  | 6,655   | 5 YEARS OF SERVICE           |
| 0075B | City of Cincinnati Employees Retirement System                                     | 6,655   | 5 YEARS OF SERVICE           |
| 0079A | OHIO SCHOOL EMPLOYEES' RETIREMENT SYSTEM   | 113,811 | 5 YEARS OF SERVICE           |
| 0086A | FT. LAUDERDALE GENERAL EMPLOYEES RETIREMENT SYSTEM                                 | 1,363   | 5 YEARS OF SERVICE           |
| 0096A | TEACHER RETIREMENT SYSTEM OF TEXAS   | 0       | 5 YEARS OF SERVICE           |
| 0097A | LONG BEACH TRANSIT PENSION PLAN - CONTRACT EMPLOYEES                               | 495     | 5 YEARS OF SERVICE           |
| 0104A | TENNESSEE CONSOLIDATED RETIREMENT SYSTEM   | 190,344 | 5 YEARS OF SERVICE           |
| 0107A | CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM DEFINED BENEFIT PLAN                  | 385,530 | 5 YEARS OF SERVICE           |
| 0109A | TUCSON SUPPLEMENTAL RETIREMENT SYSTEM  | 3,484   | 5 YEARS OF SERVICE           |
| 0111A | PUBLIC SCHOOL TEACHERS' PENSION & RETIREMENT FUND OF CHICAGO                       | 35,400  | 5 YEARS OF SERVICE           |
| 0113A | VIRGINIA RETIREMENT SYSTEM   | 286,234 | 5 YEARS OF SERVICE           |
| 0125A | PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION OF COLORADO                               | 162,106 | 5 YEARS OF SERVICE           |
| 0126A | FAIRFAX COUNTY UNIFORMED RETIREMENT SYSTEM   | 1,570   | 5 YEARS OF SERVICE           |
| 0127A | FAIRFAX COUNTY SUPPLEMENTAL RETIREMENT SYSTEM                                      | 13,044  | 5 YEARS OF SERVICE           |
| 0128A | FAIRFAX COUNTY POLICE OFFICERS' RETIREMENT SYSTEM                                  | 1,115   | 5 YEARS OF SERVICE           |
| 0137A | NEW YORK STATE TEACHERS' RETIREMENT SYSTEM   | 224,886 | 5 YEARS OF SERVICE           |
| 0138A | MISSOURI STATE EMPLOYEES' RETIREMENT PLAN  | 57,774  | 5 YEARS OF SERVICE           |

|       |   |         |                    |
|-------|---|---------|--------------------|
| 0138D | MISSOURI STATE EMPLOYEES' PLAN 2000   | 0       | 5 years of service |
| 0143A | ST LOUIS COUNTY LIBRARY DISTRICT EMPLOYEES' PENSION PLAN                    | 316     | 5 YEARS OF SERVICE |
| 0144A | OREGON PUBLIC EMPLOYEES RETIREMENT SYSTEM                                   | 158,888 | 5 YEARS OF SERVICE |
| 0148A | LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOC. PLAN A GENERAL               | 7,660   | 5 YEARS OF SERVICE |
| 0147C | PERS OF IDAHO - FIREFIGHTERS RETIREMENT FUND (CLOSED PLAN)                  | 129     | 5 YEARS OF SERVICE |
| 0154A | NORTH DAKOTA PUBLIC EMPLOYEES' RETIREMENT SYSTEM - GENERAL                  | 17,231  | 5 YEARS OF SERVICE |
| 0159A | FORT WORTH EMPLOYEES' RETIREMENT FUND                                       | 5,423   | 5 YEARS OF SERVICE |
| 0174A | WASHINGTON PUBLIC EMPLOYEES' RETIREMENT SYSTEM - PLAN I                     | 28,167  | 5 YEARS OF SERVICE |
| 0174B | WASHINGTON PUBLIC EMPLOYEES' RETIREMENT SYSTEM - PLAN II                    | 168,213 | 5 YEARS OF SERVICE |
| 0174C | WASHINGTON TEACHERS' RETIREMENT SYSTEM - PLAN I                             | 18,737  | 5 YEARS OF SERVICE |
| 0174D | WASHINGTON TEACHERS' RETIREMENT SYSTEM - PLAN II/III                        | 8,883   | 5 YEARS OF SERVICE |
| 0174E | WASHINGTON LAW ENFORCEMENT AND FIRE FIGHTERS' PLAN I                        | 1,743   | 5 YEARS OF SERVICE |
| 0174F | WASHINGTON LAW ENFORCEMENT AND FIRE FIGHTERS' PLAN II                       | 12,713  | 5 YEARS OF SERVICE |
| 0174G | WASHINGTON STATE PATROL RETIREMENT SYSTEM                                   | 988     | 5 YEARS OF SERVICE |
| 0177A | PUBLIC SCHOOL RETIREMENT SYSTEM OF THE CITY OF ST. LOUIS                    | 6,100   | 5 YEARS OF SERVICE |
| 0194A | CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT PLAN - GENERAL                    | 7,436   | 5 YEARS OF SERVICE |
| 0194B | CONTRA COSTA COUNTY RETIREMENT SYSTEM - POLICE AND FIRE                     | 1,874   | 5 YEARS OF SERVICE |
| 0195A | MONTANA PUBLIC EMPLOYEES' RETIREMENT SYSTEM                                 | 28,091  | 5 YEARS OF SERVICE |
| 0195B | MONTANA GAME WARDENS AND PEACE OFFICERS RETIREMENT SYSTEM                   | 494     | 5 YEARS OF SERVICE |
| 0195C | MONTANA JUDGES RETIREMENT SYSTEM  | 46      | 5 YEARS OF SERVICE |
| 0195D | MONTANA HIGHWAY PATROL OFFICERS RETIREMENT SYSTEM                           | 190     | 5 YEARS OF SERVICE |
| 0195E | MONTANA SHERIFFS RETIREMENT SYSTEM  | 611     | 5 YEARS OF SERVICE |
| 0195F | MONTANA MUNICIPAL POLICE OFFICERS RETIREMENT SYSTEM                         | 671     | 5 YEARS OF SERVICE |
| 0202A | NEW YORK STATE & LOCAL EMPLOYEES' RET. SYSTEM - GENERAL                     | 720,223 | 5 YEARS OF SERVICE |
| 0202B | NEW YORK STATE & LOCAL POLICE AND FIRE RETIREMENT SYSTEM                    | 31,955  | 5 YEARS OF SERVICE |
| 0206A | MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION                              | 2,988   | 5 YEARS OF SERVICE |
| 0221A | EAST BAY MUNICIPAL UTILITY DISTRICT   | 1,853   | 5 YEARS OF SERVICE |
| 0224D | LA COUNTY METRO TRANSIT AUTH. - NON-CONTRACT EMPLOYEE RIP                   | 427     | 5 YEARS OF SERVICE |
| 0231A | AURORA GENERAL EMPLOYEES RETIREMENT PLAN                                    | 1,493   | 5 YEARS OF SERVICE |
| 0236A | NEBRASKA DEFINED CONTRIBUTION PLANS - STATE EMPLOYEES                       | 14,889  | 5 YEARS OF SERVICE |
| 0236B | NEBRASKA DEFINED CONTRIBUTION PLANS - COUNTY EMPLOYEES                      | 8,872   | 5 YEARS OF SERVICE |
| 0248A | STATE UNIVERSITIES RETIREMENT SYSTEM OF ILLINOIS                            | 72,365  | 5 YEARS OF SERVICE |
| 0245B | STATE UNIVERSITIES RETIREMENT SYSTEM OF ILLINOIS (DC PLAN)                  | 5,880   | 5 YEARS OF SERVICE |
| 0277A | CITY OF ST. LOUIS EMPLOYEE RETIREMENT PLAN                                  | 5,948   | 5 YEARS OF SERVICE |
| 0278D | CALIFORNIA JUDGES RETIREMENT FUND (II)                                      | 445     | 5 YEARS OF SERVICE |
| 0291A | MILWAUKEE COUNTY EMPLOYEES' RETIREMENT PLAN                                 | 7,246   | 5 YEARS OF SERVICE |
| 0303A | ALASKA PUBLIC EMPLOYEES' RETIREMENT SYSTEM                                  | 0       | 5 YEARS OF SERVICE |
| 0316A | LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM                               | 24,234  | 5 YEARS OF SERVICE |
| 0321A | SAN JOAQUIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION                        | 5,231   | 5 YEARS OF SERVICE |
| 0325A | CITY OF GERMANTOWN EMPLOYEE RETIREMENT PLAN                                 | 377     | 5 YEARS OF SERVICE |
| 0363A | DENVER EMPLOYEES RETIREMENT PLAN  | 10,821  | 5 YEARS OF SERVICE |
| 0368A | Denver Public Schools Retirement System                                     | 7,182   | 5 YEARS OF SERVICE |
| 0373A | PERA OF NEW MEXICO  | 54,647  | 5 YEARS OF SERVICE |
| 0374A | STATE EMPLOYEES RETIREMENT SYSTEM OF MARYLAND                               | 178,456 | 5 YEARS OF SERVICE |
| 0379A | Kern County Employees' Retirement Association                               | 7,109   | 5 years of service |
| 0387A | CITY OF ENGLEWOOD NON-EMERGENCY PENSION PLAN                                | 231     | 5 YEARS OF SERVICE |
| 0387B | CITY OF ENGLEWOOD POLICE PENSION PLAN                                       | 11      | 5 YEARS OF SERVICE |
| 0387C | CITY OF ENGLEWOOD FIREFIGHTER'S PENSION PLAN                                | 10      | 5 YEARS OF SERVICE |
| 0388B | TOWN OF AVON PUBLIC WORKS RETIREMENT PLAN                                   | 14      | 5 YEARS OF SERVICE |
| 0388C | TOWN OF AVON NON-ORGANIZED RETIREMENT PLAN                                  | 32      | 5 YEARS OF SERVICE |
| 0388D | TOWN OF AVON BOARD OF EDUCATION RETIREMENT PLAN                             | 38      | 5 YEARS OF SERVICE |
| 0388E | Town of Avon 401(a) f.l. Employees' Plan                                    | 26      | 5 YEARS OF SERVICE |
| 0418A | CIVILIAN EMPLOYEES' RETIREMENT SYSTEM OF THE POLICE DEPARTMENT OF K.C., MO. | 583     | 5 YEARS OF SERVICE |
| 0422A | MONTANA TEACHERS' RETIREMENT SYSTEM   | 18,205  | 5 YEARS OF SERVICE |
| 0424A | JUDICIAL RETIREMENT SYSTEM OF NEW JERSEY                                    | 414     | 5 YEARS OF SERVICE |
| 0449A | EMPLOYEES' RETIREMENT SYSTEM OF TULSA COUNTY, OKLAHOMA                      | 1,389   | 5 YEARS OF SERVICE |

|       |   |         |  |
|-------|---|---------|--|
| 0453A | CITY OF ARNOLD (MO) POLICE PENSION PLAN                             | 48      | 5 YEARS OF SERVICE   |
| 0454A | SAN BERNARDINO COUNTY EMPLOYEES RETIREMENT ASSOCIATION              | 15,858  | 5 YEARS OF SERVICE   |
| 0462A | Employees' Retirement System of Montgomery County                   | 8,398   | 5 YEARS OF SERVICE   |
| 0737A | Town of Suffield Pension Plan                                       | 138     | 5 years of service   |
| 0146D | LOS ANGELES COUNTY EMPLOYEES' RET. ASSOC., PLAN D: GENERAL          | 31,300  | 5 YEARS OF SERVICE AND 10 YEARS OF MEMBERSHIP  |
| 0146F | LOS ANGELES COUNTY EMPLOYEES' RET. ASSOC., PLAN A SAFETY            | 2,005   | 5 YEARS OF SERVICE AND 10 YEARS OF MEMBERSHIP  |
| 0146G | LOS ANGELES COUNTY EMPLOYEES' RET. ASSOC., PLAN B SAFETY            | 9,289   | 5 YEARS OF SERVICE AND 10 YEARS OF MEMBERSHIP  |
| 0146B | LOS ANGELES COUNTY EMPLOYEES' RET. ASSOC., PLAN B: GENERAL          | 558     | 5 YEARS OF SERVICE, 10 YEARS OF MEMBERSHIP   |
| 0146C | LOS ANGELES COUNTY EMPLOYEES' RET. ASSOC., PLAN C: GENERAL          | 413     | 5 YEARS OF SERVICE, 10 YEARS OF MEMBERSHIP   |
| 0063A | TEACHERS' RETIREMENT SYSTEMS OF ILLINOIS                            | 144,975 | 5 YEARS OF SERVICE; ALSO SINGLE-SUM BENEFIT PAYABLE AT 65 IF < 5 YEARS                 |
| 0034A | ARKANSAS LOCAL POLICE & FIRE RETIREMENT SYSTEM                      | 7,983   | 5 YRS  |
| 0700A | Defined Benefit - Douglas County Employees Retirement Trust         | 0       | 5 yrs  |
| 0542A | City of St Petersburg Employee Retirement System                    | 1,798   | 5 yrs of service   |
| 0160A | VIA METROPOLITAN TRANSIT RETIREMENT PLAN                            | 1,409   | 50% VESTED AT 5 YEARS, GRADED TO 100% AT 10 YEARS OF SERVICE                           |
| 0043E | MN STATE RETIREMENT SYSTEM LEGISLATORS' RETIREMENT PLAN             | 173     | 6 YEARS  |
| 0057A | WYOMING WARDEN AND PATROL RETIREMENT PLAN                           | 260     | 6 YEARS  |
| 0165D | UTAH JUDGES' RETIREMENT SYSTEM                                      | 104     | 6 YEARS OF SERVICE   |
| 0310A | Iowa Judicial Retirement Fund                                       | 194     | 6 years of service   |
| 0007C | ILLINOIS JUDGES' RETIREMENT SYSTEM                                  | 908     | 6 YEARS OF SERVICE (AGE 62); 10 YEARS OF SERVICE (AGE 60); 2 YEARS OF SERVICE (AGE 62) |
| 0145A | PERS OF OHIO - STATE AND LOCAL DIVISION                             | 392,530 | 60 CONTRIBUTING MONTHS   |
| 0145B | PERS OF OHIO - LAW ENFORCEMENT DIVISION                             | 7,389   | 60 CONTRIBUTING MONTHS   |
| 0156A | WICHITA EMPLOYEES' RETIREMENT PLAN                                  | 1,018   | 7 YEARS OF SERVICE   |
| 0156C | Wichita Employees' Retirement System Plan 3                         | 878     | 7 years of service   |
| 0217A | LANSING BOARD OF WATER AND LIGHT EMPLOYEES' DEFINED BENEFIT PLAN    | 121     | 7 YEARS OF SERVICE   |
| 0217B | LANSING BOARD OF WATER AND LIGHT DEFINED CONTRIBUTION PENSION PLANS | 636     | 7 YEARS OF SERVICE   |
| 0542B | City of St Petersburg Firefighters Retirement System                | 298     | 7 years of service   |
| 0542C | City of St Petersburg Police Officers Retirement System             | 457     | 7 years of service   |
| 0371A | SHELBY COUNTY RETIREMENT SYSTEM                                     | 6,271   | 7 1/2 YEARS OF SERVICE   |
| 0007A | ILLINOIS STATE EMPLOYEES' RETIREMENT SYSTEM                         | 80,678  | 8 YEARS  |
| 0037A | KALAMAZOO COUNTY EMPLOYEES' RETIREMENT PLAN                         | 1,064   | 8 YEARS  |
| 0043F | MN STATE RET. SYSTEM ELECTIVE OFFICERS' RET. PLAN                   | 0       | 8 YEARS  |
| 0064D | EMPLOYEES' RETIREMENT SYSTEM OF GEORGIA - LEGISLATIVE               | 210     | 8 YEARS  |
| 0110A | ILLINOIS MUNICIPAL RETIREMENT FUND                                  | 157,816 | 8 YEARS  |
| 0169A | OKLAHOMA PUBLIC EMPLOYEES RETIREMENT SYSTEM                         | 42,886  | 8 YEARS  |
| 0173A | WAYNE COUNTY EMPLOYEES' RETIREMENT SYSTEM                           | 5,407   | 8 YEARS  |
| 0183A | MICHIGAN JUDGES' RETIREMENT SYSTEM                                  | 389     | 8 YEARS  |
| 0007B | ILLINOIS GENERAL ASSEMBLY RETIREMENT SYSTEM                         | 161     | 8 YEARS (AGE 55); 4 YEARS (AGE 62)   |
| 0289A | GOGEBIC COUNTY EMPLOYEES RETIREMENT PLAN                            | 375     | 8 YEARS OF SERVICE   |
| 0304A | ALASKA TEACHERS' RETIREMENT SYSTEM                                  | 9,164   | 8 YEARS OF SERVICE   |
| 0329A | CITY OF GRAND RAPIDS GENERAL EMPLOYEES' RETIREMENT SYSTEM           | 1,176   | 8 YEARS OF SERVICE   |
| 0451A | ELK COUNTY EMPLOYEES' RETIREMENT PLAN                               | 132     | 8 YEARS OF SERVICE   |
| 0474A | VILLAGE OF MOUNT PROSPECT-POLICE                                    | 82      | 8 YEARS OF SERVICE   |
| 0195I | MONTANA PUBLIC EMPLOYEES' RETIREMENT DEFERRED COMPENSATION          | 7,048   | ACCOUNT BALANCES ARE FULLY VESTED AT TIME OF DEPOSIT                                   |
| 0087B | NEW HAMPSHIRE RETIREMENT SYSTEM - TEACHERS' PLAN                    | 14,114  | AGE 60 W/ ANY YEARS  |
| 0235A | NEBRASKA PERS SCHOOL PLAN   | 34,718  | AGE 65 WITH 5 YEARS CREDITED SERVICE; AGE 65 REGARDLESS OF SERVICE                     |
| 0426A | CONSOLIDATED POLICE & FIREMEN'S PENSION FUND OF NEW JERSEY (CPFPF)  | 43,331  | CLOSED PLAN, NO ACTIVE MEMBERS   |
| 0098A | WISCONSIN RETIREMENT SYSTEM   | 258,195 | IMMEDIATE VESTING  |
| 0107B | CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM CASH BALANCE PROGRAM   | 9,552   | IMMEDIATE VESTING  |
| 0138B | MISSOURI ADMINISTRATIVE LAW JUDGES' RETIREMENT PLAN                 | 52      | IMMEDIATE VESTING  |
| 0138C | MISSOURI REGULAR JUDGES' RETIREMENT PLAN                            | 375     | IMMEDIATE VESTING  |
| 0235C | NEBRASKA PERS JUDGES' RETIREMENT PLAN                               | 157     | IMMEDIATE VESTING  |
| 0505A | VILLAGE OF BOLINGBROOK POLICE PENSION PLAN                          | 88      | IMMEDIATE VESTING  |
| 0542D | City of St Petersburg   | 100     | Immediate vesting  |
| 0057B | WYOMING VOLUNTEER FIREMEN'S PLAN                                    | 2,118   | MUST BE VOLUNTEER UNTIL AGE 60   |
| 0090A | Charlotte Firefighters' Retirement Plan                             | 0       |  |
| 0534A | Miami Shores General Employees Retirement Plan                      | 0       |  |

|       |   |           |
|-------|---|-----------|
| 0650A | Fairfax County Water Authority Retirement Plan                          | 0         |
| 0655A | Spokane Employees' Retirement Plan                                      | 0         |
|       | Number of plans with vesting requirements of 10 or more years           | 98        |
|       | Active members of plans with vesting requirements of 10 or more years   | 3,662,540 |
|       | Number of plans with vesting requirements of less than 10 years         | 172       |
|       | Active members of plans with vesting requirements of less than 10 years | 5,988,342 |
|       | Number of plans with vesting requirements of 5 years or less            | 132       |
|       | Active members of plans with vesting requirements of 5 years or less    | 4,908,400 |

\* About 50,000 members in Tier 2



WISCONSIN LEGISLATIVE COUNCIL

# 2002 COMPARATIVE STUDY OF MAJOR PUBLIC EMPLOYEE RETIREMENT SYSTEMS

Prepared by:

William Ford, Senior Staff Attorney  
Wisconsin Legislative Council

December 2003



## **PART III**

### **CONTRIBUTION AND VESTING REQUIREMENTS**

#### **A. INTRODUCTION**

Chart 3, on pages 18 and 19, shows the vesting period, the employee contribution rate, and the employer contribution rate for each of the 85 plans in the report. The contribution rates are shown as a percentage of salary.

#### **B. VESTING**

The term "vesting" refers to an employee's right, after satisfying some minimum service requirement, to receive a pension benefit regardless of whether the employee remains in a job covered by the pension plan. Vesting requirements for the plans included in the 2002 Report are displayed in the last column of Chart 3. The following table shows the changes that have occurred since 2000 in the plans covered by the report:

|                        | <u><b>2000 Report</b></u> | <u><b>2002 Report</b></u> |
|------------------------|---------------------------|---------------------------|
| Immediate vesting      | 2 plans                   | 2 plans                   |
| Vesting after 3 years  | 6 plans                   | 6 plans                   |
| Vesting after 4 years  | 5 plans                   | 5 plans                   |
| Vesting after 5 years  | 42 plans                  | 47 plans                  |
| Vesting after 8 years  | 4 plans                   | 4 plans                   |
| Vesting after 10 years | 25 plans                  | 20 plans                  |
| Graded or varying      | 1 plan                    | 1 plan                    |
| <b>TOTAL</b>           | <b>85 plans</b>           | <b>85 plans</b>           |

In 2002, a total of 60 plans, or 71% of the 85 plans in the report, require five years or less years of service to vest. This is an increase of 6 plans since the 2000 Report. The trend appears to be towards vesting periods of 5 years or less, perhaps reflecting federal vesting requirements that apply to private sector pension plans. The number of plans in 2002 that require 10 years of service to vest has decreased by 5 plans from the 2000 Report and by 20 plans from the 1990 report.

#### **B. EMPLOYEE CONTRIBUTIONS**

Large private sector corporations that provide pension plans frequently do not require employee contributions to the primary plan, but frequently also provide supplemental profit-sharing or savings plans which allow employees to contribute to the plan and receive an employer "match" to some or all of the contribution. Conversely, most public employee pension plans at least nominally require employees to contribute a certain percentage of their salary to the plan, although, as will be discussed below, some public employee pension plans provide for employer "pick-up" of the employee contribution. In addition, secondary savings plans for public



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The State Actuary

May 13, 2004

Senator Shirley Winsley  
Chair, Select Committee on Pension Policy  
P O Box 40914  
Olympia, WA 98504-0914

Dear Senator Winsley:

The Washington School Personnel Association has a growing concern with Plan 3 retirement systems. Our primary focus is the Teachers Retirement System (TRS), however the challenges and concerns are equally applicable to School Employees' Retirement System (SERS) and Public Employees Retirement System (PERS). We very much appreciate the commitment by the Select Committee to study this issue ("Working Until Age 65") during the 2004 interim. The purpose of this letter is to offer a study guideline for your consideration.

As structured, an employee must effectively work to age 65 to qualify for a viable retirement. For teachers, this means remaining in the classroom for forty to forty-five (40-45) years after acquiring a basic education degree. While teachers are lifelong learners, the expectation of maintaining a viable mastery of knowledge over such a pro-longed period of time is overwhelming. Further, the age requirement fails to appreciate the rigors of performing the duties of a classroom teacher over such an extended period.

We recognize that in designing Plan 3, legislatures acted on the assumption that the defined benefit portion of the retirement plan (1% per year) would become secondary to the defined contribution (investment) in value, and that the added portability of the investment portion would provide an attractive alternative to those leaving service before age 65. It is interesting to note that recent news articles state that participation in 401K plans decreased 2.5% in 2002 and another 3.6% in 2003, and currently rests at 72.6% participation. The same source noted that 42% of workers must cash out their 401K investment when changing jobs. We see this as a more than a transition. Clearly employees recognize that the investment returns of the 1990's were an anomaly that is not likely to be repeated in the future. Consequently, a viable defined benefit is essential to the total compensation package necessary to attract and retain quality educators.

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Patty Laughery, Moses Lake

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Jan Lande, Tukwila  
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Greg Roberts, South Kitsap

Region VI  
Debby Carter, Edmonds

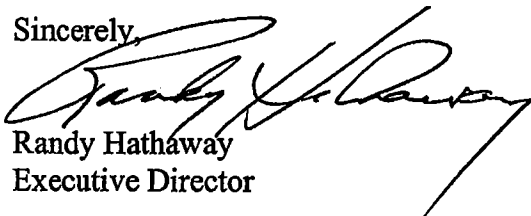
In today's environment and the foreseeable future, 1% per year (30% over three years) is not a viable amount. This is particularly critical, when one considers the severity of the penalty for early retirement. A teacher retiring at age 55 with 30 years of services would only be entitled to 70% of their average earnings for a net benefit of 21% for 30 years of service. The same employee with 29 years of service would be subject to an actuarial reduction instead of a fixed 3% reduction and would only receive 37% of their defined benefit, or 11.1%. With these parameters, working to age 65 becomes mandatory; not an option.

A final, and extremely significant, concern with Plan 2 and 3 is the inability to purchase service credit for out of state service. School Districts increasingly conduct interstate recruiting. Teachers who are vested in another state and who have no opportunity to purchase service credit in Washington State are increasingly less likely to consider a transfer. A purchase option must be available and affordable. Prior provisions for purchasing out of state service credit (i.e., Plan 1) required that the employee pay the full actuarial value for such credit. This rendered it unaffordable. The example used in DRS Information Sheets discloses that an employee earning \$50,000, who is 50 years of age, who purchases 3 years of service credit will be required to pay \$34,159 dollars. In a recruitment and retention perspective, the objective is not zero cost to the State of Washington. Rather, it is treating the experience as though it had been earned in Washington in exchange for the commitment to future Washington employment.

We understand that resolving these concerns has significant cost considerations. However, in that regard, we note that the Washington State contribution to employee retirement in TRS 3 has declined from 11.94% in 1999 to 1.39% in 2003. While this helped balance budget deficits during difficult years, it did so by removing the funding capacity from the retirement system that would have allowed for necessary changes. We believe that with difficult times beginning to move to the past, it should be a legislative priority to restore this "borrowed" funding capacity. We believe new funding ideas, as well as restoration of state contributions, are necessary to create an affordable and financially viable system for both the State and the employee.

We ask that the State Actuary consider alternatives to the above considerations in the conduct of the interim study. As always, the Association, representing School District Human Resource professionals across the State, appreciates the positive and supportive position taken by the Select Committee and the preceding Joint Pension Policy Committee.

Sincerely,



Randy Hathaway  
Executive Director

cc: Barb Mertens, WASA

## Washington Public Employees Association, UFCW Local 365

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May 23, 2005

TO: Senator Karen Fraser, Chair  
Members of the Select Committee on Pension Policy  
State Actuary Staff

FROM: Lynn Maier, Governmental Relations Director 

SUBJECT: Requested Interim Study Issues

As you develop a potential interim work plan, I respectfully request that you consider issues important to WPEA outlined below.

Of most significance is the directive given to the SCPP via passage of HB 1044 to study options regarding the liability associated with future gain-sharing distributions given the legislature's choice to suspend gain-sharing for the 2005-07 biennium.

As you may recall, WPEA joined a host of other employee organizations in strong support of the package recommended to the legislature by the SCPP providing for a modified Rule of 90 in Plans 2 and 3 and modest improvements in Plan 1 in lieu of gain-sharing. We remain steadfast in our support of the original package and in our desire to achieve a viable trade-off for the loss of gain-sharing. And, we urge Committee members to revisit this issue with vigor with the intent of developing a comparable set of recommendations to the 2006 legislature. We also urge the SCPP to revisit the issue of 5-year vesting in Plan 3.

In addition to the above, we would appreciate SCPP consideration this interim of the following issues:

- Inclusion of DNR Natural Resource Investigators, DNR Forest Crew Supervisors and Deputy State Fire Marshals in the Public Safety Employees Retirement System (PSERS)
- Military service credit in PERS 2 and 3 comparable with PERS 1 (WPEA initiated HB 1522/SB 5521)
- Plan 2 access to state health plans at age 55 with at least 10 years of service on *separation* from employment (WPEA initiated HB 1520/SB 5520)

Regarding our request for additions to PSERS, we believe that the duties of the job classes enumerated meet the intent of the enabling legislation regarding physical risk and public protection of lives and property. PSERS goes into effect in July 2006, thus it is imperative that attention be given to our request to ensure consideration in the next legislative session.

Thank you for your consideration of these issues. I look forward to working with you during the interim.

# Plan 3 Vesting

1 AN ACT Relating to vesting after five years of service in the  
2 defined benefit portion of the public employees' retirement system, the  
3 school employees' retirement system, and the teachers' retirement  
4 system plan 3; and amending RCW 41.32.875, 41.35.680, and 41.40.820.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

6 **Sec. 1.** RCW 41.32.875 and 2000 c 247 s 903 are each amended to  
7 read as follows:

8 (1) NORMAL RETIREMENT. Any member who is at least age sixty-five  
9 and who has ~~((+)~~

10 ~~((a)))~~ completed ~~((ten))~~ five service credit years ~~((+ or~~  
11 ~~((b) Completed five service credit years, including twelve service~~  
12 ~~credit months after attaining age fifty-four; or~~

13 ~~((e)))~~ or completed five service credit years by July 1, 1996, under  
14 plan 2 and who transferred to plan 3 under RCW 41.32.817 ~~((+))~~  
15 shall be eligible to retire and to receive a retirement allowance  
16 computed according to the provisions of RCW 41.32.840.

17 (2) EARLY RETIREMENT. Any member who has attained at least age  
18 fifty-five and has completed at least ten years of service shall be  
19 eligible to retire and to receive a retirement allowance computed

1 according to the provisions of RCW 41.32.840, except that a member  
2 retiring pursuant to this subsection shall have the retirement  
3 allowance actuarially reduced to reflect the difference in the number  
4 of years between age at retirement and the attainment of age sixty-  
5 five.

6 (3) ALTERNATE EARLY RETIREMENT. Any member who has completed at  
7 least thirty service credit years and has attained age fifty-five shall  
8 be eligible to retire and to receive a retirement allowance computed  
9 according to the provisions of RCW 41.32.840, except that a member  
10 retiring pursuant to this subsection shall have the retirement  
11 allowance reduced by three percent per year to reflect the difference  
12 in the number of years between age at retirement and the attainment of  
13 age sixty-five.

14 **Sec. 2.** RCW 41.35.680 and 2000 c 247 s 906 are each amended to  
15 read as follows:

16 (1) NORMAL RETIREMENT. Any member who is at least age sixty-five  
17 and who has ((+)

18 ~~((a))) completed ((ten)) five service credit years((+ or~~  
19 ~~((b)) Completed five service credit years, including twelve service~~  
20 ~~credit months after attaining age fifty-four; or~~

21 ~~((c))) or completed five service credit years by September 1, 2000,~~  
22 under the public employees' retirement system plan 2 and who  
23 transferred to plan 3 under RCW 41.35.510((+))  
24 shall be eligible to retire and to receive a retirement allowance  
25 computed according to the provisions of RCW 41.35.620.

26 (2) EARLY RETIREMENT. Any member who has attained at least age  
27 fifty-five and has completed at least ten years of service shall be  
28 eligible to retire and to receive a retirement allowance computed  
29 according to the provisions of RCW 41.35.620, except that a member  
30 retiring pursuant to this subsection shall have the retirement  
31 allowance actuarially reduced to reflect the difference in the number  
32 of years between age at retirement and the attainment of age sixty-  
33 five.

34 (3) ALTERNATE EARLY RETIREMENT. Any member who has completed at  
35 least thirty service credit years and has attained age fifty-five shall  
36 be eligible to retire and to receive a retirement allowance computed  
37 according to the provisions of RCW 41.35.620, except that a member

1 retiring pursuant to this subsection shall have the retirement  
2 allowance reduced by three percent per year to reflect the difference  
3 in the number of years between age at retirement and the attainment of  
4 age sixty-five.

5 **Sec. 3.** RCW 41.40.820 and 2000 c 247 s 309 are each amended to  
6 read as follows:

7 (1) NORMAL RETIREMENT. Any member who is at least age sixty-five  
8 and who has ((÷

9 ~~((a))) completed ((ten)) five service credit years ((÷ or~~  
10 ~~((b)) Completed five service credit years, including twelve service~~  
11 ~~credit months after attaining age fifty-four; or~~

12 ~~((c))) or completed five service credit years by the transfer~~  
13 payment date specified in RCW 41.40.795, under the public employees'  
14 retirement system plan 2 and who transferred to plan 3 under RCW  
15 41.40.795 ((÷))

16 shall be eligible to retire and to receive a retirement allowance  
17 computed according to the provisions of RCW 41.40.790.

18 (2) EARLY RETIREMENT. Any member who has attained at least age  
19 fifty-five and has completed at least ten years of service shall be  
20 eligible to retire and to receive a retirement allowance computed  
21 according to the provisions of RCW 41.40.790, except that a member  
22 retiring pursuant to this subsection shall have the retirement  
23 allowance actuarially reduced to reflect the difference in the number  
24 of years between age at retirement and the attainment of age sixty-  
25 five.

26 (3) ALTERNATE EARLY RETIREMENT. Any member who has completed at  
27 least thirty service credit years and has attained age fifty-five shall  
28 be eligible to retire and to receive a retirement allowance computed  
29 according to the provisions of RCW 41.40.790, except that a member  
30 retiring pursuant to this subsection shall have the retirement  
31 allowance reduced by three percent per year to reflect the difference  
32 in the number of years between age at retirement and the attainment of  
33 age sixty-five.

--- END ---

# DRAFT FISCAL NOTE

REQUEST NO.

|                             |       |         |              |
|-----------------------------|-------|---------|--------------|
| RESPONDING AGENCY:          | CODE: | DATE:   | BILL NUMBER: |
| Office of the State Actuary | 035   | 10/6/05 | Z-0784.1     |

## SUMMARY OF BILL:

This bill impacts the Teachers Retirement System (TRS), School Employee's Retirement System (SERS), and Public Employee's Retirement System (PERS) Plans 3 by lowering the vesting period for the defined benefit portion of these plans from ten years to five.

Effective Date: 90 days after session.

## CURRENT SITUATION:

New Plan 3 members of TRS, SERS, and PERS are vested in the defined benefit portion of their Plan after ten years of service, or after five years of service if 12 months of that service is earned after attaining age 54. Plan 3 members are immediately vested in the defined contribution side of their Plan. Those who transferred from Plan 2 to Plan 3 were automatically vested if they had five years of service in Plan 2 as of July 1, 1996, September 1, 2000, and June 1, 2003, for TRS, SERS and PERS respectively.

## MEMBERS IMPACTED:

The counts of active vested and non-vested members are shown below. Not included in these counts are terminated non-vested members who would add to the total should they become re-employed. As of the most recent valuation, 58,101 out of 98,587 Plan 3 members had less than ten years of service or were not vested based on service in Plan 2, or did not have five years of service including 12 months after age 54. Any of these non-vested members would be affected by this bill if they were to leave public employment with between five to ten years of service and before they earned 12 months of service after age 54.

| System/ Plan | Vested | Non-Vested |
|--------------|--------|------------|
| PERS 3       | 9,447  | 10,408     |
| TRS 3        | 19,979 | 29,323     |
| SERS 3       | 11,060 | 18,370     |



## FISCAL IMPACT:

### Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

| <i>(Dollars in Millions)</i>  |                 | Current    | Increase | Total      |
|---|-----------------|------------|----------|------------|
| <b>Actuarial Present Value of Projected Benefits</b>                                    | <b>PERS 2/3</b> | \$ 15,280  | \$ 5     | \$ 15,285  |
| (The Value of the Total Commitment to all Current Members)                              | <b>TRS 2/3</b>  | \$ 5,256   | \$ 11    | \$ 5,267   |
|   | <b>SERS 2/3</b> | \$ 2,126   | \$ 7     | \$ 2,133   |
| <b>Unfunded Actuarial Accrued Liability</b>   |                 | N/A        | N/A      | N/A        |
| (The Portion of the Plan 1 Liability that is Amortized at 2024)                         |                 |            |          |            |
| <b>Unfunded Liability (PBO)</b>   | <b>PERS 2/3</b> | \$ (2,927) | \$ 2     | \$ (2,925) |
| (The Value of the Total Commitment to all Current Members Attributable to Past Service) | <b>TRS 2/3</b>  | \$ (1,427) | \$ 6     | \$ (1,421) |
|   | <b>SERS 2/3</b> | \$ (439)   | \$ 4     | \$ (435)   |

### Increase in Contribution Rates:

(Effective 9/1/06)

|                        | PERS  | TRS   | SERS  |
|------------------------|-------|-------|-------|
| <b>Current Members</b> |       |       |       |
| Employee               | 0.01% | 0.03% | 0.05% |
| Employer State         | 0.01% | 0.03% | 0.05% |
| <b>New Entrants*</b>   |       |       |       |
| Employee               | 0.04% | N/A   | N/A   |
| Employer State         | 0.04% | 0.06% | 0.18% |

\*Rate change applied to future new entrant payroll and used for fiscal budget determinations only. A single supplemental rate increase, equal to the increase for current members, would apply initially for all members or employers.

## Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures is projected to be:

| <b>Costs (in Millions):</b> | <b>PERS</b>   | <b>TRS</b>    | <b>SERS</b>   | <b>Total</b>   |
|-----------------------------|---------------|---------------|---------------|----------------|
| <b>2006-2007</b>            |               |               |               |                |
| <b>State:</b>               |               |               |               |                |
| General Fund                | \$0.2         | \$0.9         | \$0.4         | \$1.5          |
| Non-General Fund            | <u>\$0.4</u>  | <u>\$0.0</u>  | <u>\$0.0</u>  | <u>\$0.4</u>   |
| <b>Total State</b>          | <b>\$0.6</b>  | <b>\$0.9</b>  | <b>\$0.4</b>  | <b>\$1.9</b>   |
| Local Government            | \$0.5         | \$0.5         | \$0.6         | \$1.6          |
| Total Employer              | \$1.1         | \$1.4         | \$1.0         | \$3.5          |
| Total Employee              | \$0.7         | \$0.1         | \$0.2         | \$1.0          |
| <b>2007-2009</b>            |               |               |               |                |
| <b>State:</b>               |               |               |               |                |
| General Fund                | \$0.6         | \$2.1         | \$1.1         | \$3.8          |
| Non-General Fund            | <u>\$1.1</u>  | <u>\$0.0</u>  | <u>\$0.0</u>  | <u>\$1.1</u>   |
| <b>Total State</b>          | <b>\$1.7</b>  | <b>\$2.1</b>  | <b>\$1.1</b>  | <b>\$4.9</b>   |
| Local Government            | \$1.5         | \$1.1         | \$1.7         | \$4.3          |
| Total Employer              | \$3.2         | \$3.2         | \$2.8         | \$9.2          |
| Total Employee              | \$1.9         | \$0.2         | \$0.4         | \$2.5          |
| <b>2006-2031</b>            |               |               |               |                |
| <b>State:</b>               |               |               |               |                |
| General Fund                | \$24.0        | \$70.7        | \$48.9        | \$143.6        |
| Non-General Fund            | <u>\$46.4</u> | <u>\$0.0</u>  | <u>\$0.0</u>  | <u>\$46.4</u>  |
| <b>Total State</b>          | <b>\$70.4</b> | <b>\$70.7</b> | <b>\$48.9</b> | <b>\$190.0</b> |
| Local Government            | \$63.8        | \$35.2        | \$73.7        | \$172.7        |
| Total Employer              | \$134.2       | \$105.9       | \$122.6       | \$362.7        |
| Total Employee              | \$70.3        | \$1.5         | \$3.0         | \$74.8         |

## State Actuary's Comments:

This bill does not modify the employee/employer level of cost sharing as defined in the actuarial funding chapter – Chapter 41.45 RCW. As a result, the cost of this Plan 3 benefit enhancement is shared equally among Plan 2/3 employers and Plan 2 employees.

## STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Teacher's Retirement System, School Employees' Retirement System, and Public Employees' Retirement System. Fiscal Budget Determinations were based on preliminary 2004 data.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:
4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
5. This draft fiscal note is intended for use only during the 2006 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.
8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members. Rate increases are based on rates that exclude the cost of future gain-sharing benefits.

## GLOSSARY OF ACTUARIAL TERMS:

**Actuarial accrued liability:** Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

**Actuarial Present Value:** The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

**Aggregate Funding Method:** The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

**Entry Age Normal Cost Method (EANC):** The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

**Normal Cost:** Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

**Pension Benefit Obligation (PBO):** The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

**Projected Benefits:** Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

**Unfunded Liability (Unfunded PBO):** The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

**Unfunded Actuarial Accrued Liability (UAAL):** The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.